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The Economist

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Russia v NATO, again

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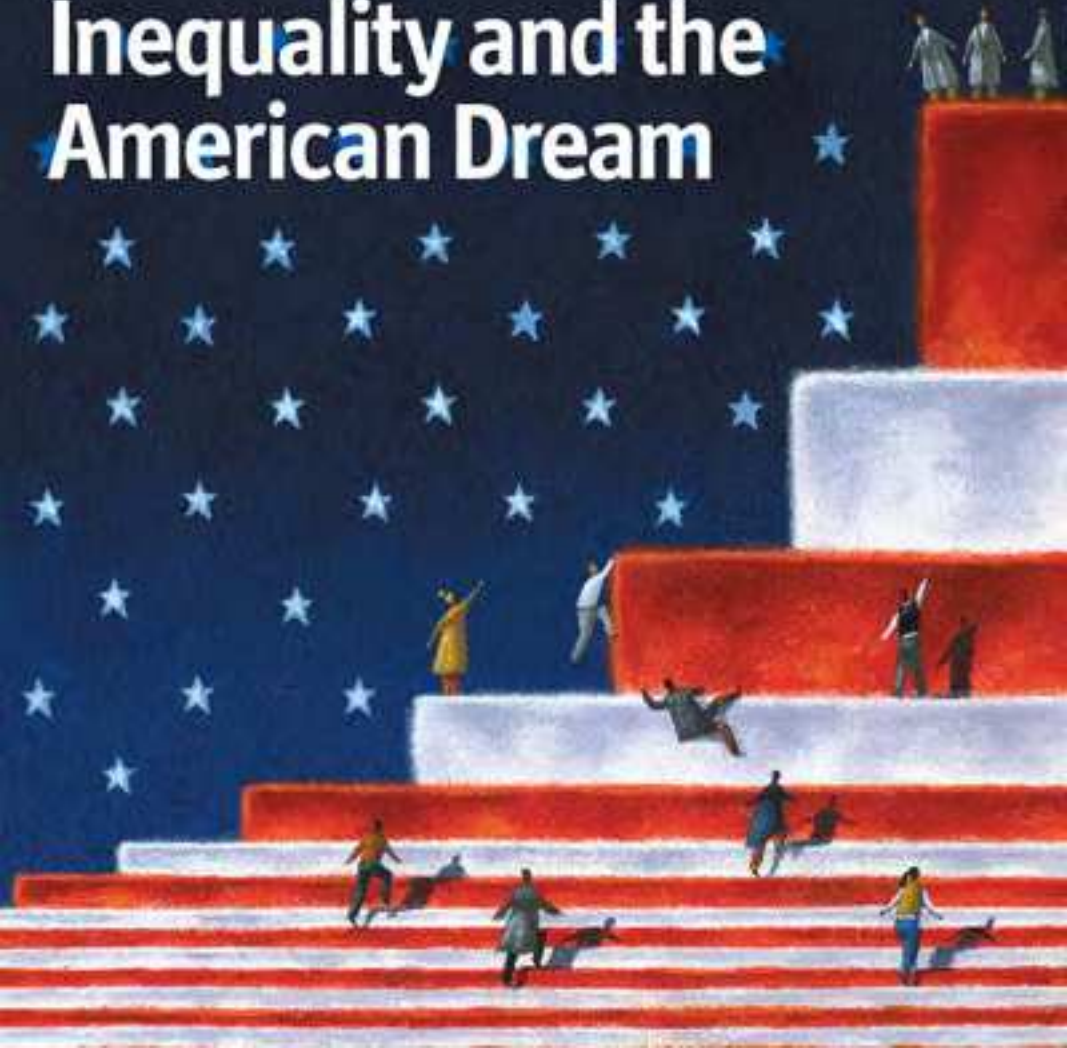
Is there an alternative to Google?

The Hamas conundrum

The bond market and inflation

Inequality and the American Dream



ONLINE FEATURES

Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers

GLOBAL AGENDA
POLITICS THIS WEEK
BUSINESS THIS WEEK
OPINION
Leaders
Letters
WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide
SURVEYS
BUSINESS
Management Reading
Business Education
Executive Dialogue
FINANCE & ECONOMICS
Economics Focus
Economics A-Z
SCIENCE & TECHNOLOGY
Technology Quarterly
PEOPLE
Obituary
BOOKS & ARTS
Style Guide
MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index
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DELIVERY OPTIONS
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Print Edition June 17th 2006

On the cover
The world's most impressive economic machine needs a little adjusting: leader

Previous print editions

Jun 10th 2006
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The world this week

Politics this week
Business this week

Leaders

The United States
Inequality and the American Dream

The logistics revolution
Chain reaction

Steel takeovers
Cast-iron

Whaling
Too much blubber

Israel and Palestine
The Hamas conundrum

America's war for hearts and minds
Mind your language

Letters

On America and Israel, Europe, Slovakia, Haditha, Indonesia, petrol prices, Alberta, American unions

Special Report

Inequality in America
The rich, the poor and the growing gap between them

United States

Immigration and "The Jungle"
Of meat, Mexicans and social mobility

Maine politics
Keeping it clean

Virginia politics
Webb's way

The president's ratings
Up at last

New Orleans
Beyond the razor-wire

Baseball bats
The magic of maple

Crime
Bad news about bad guys

Lexington
Doubting Hillary

The Americas

Infrastructure in Latin America
Slow! Government obstacles ahead

Cuba
Send in the social workers

Argentina
Taking on the penguins

Asia

Inequality in Japan
The rising sun leaves some Japanese in the shade

Taiwan
Shui-bian agonistes

A survey of logistics

The physical internet
Shining examples
Manufacturing complexity
Cargo cults
Just-in-time lobsters
Chain reactions
Delivering the goods
When the chain breaks
Sources
Offer to readers

Business

Internet search engines
The un-Google

New media
Blogging off

Pharmaceuticals
Bayer beware

Aerospace
Stuck on the runway

Steel
Arcelor wobbles

Corporate governance
The shareholders' revolt

Business in Calabria
Bullets in the post

Face value
Blowhard

Special Report

Work-life balance
Life beyond pay

Finance & Economics

Global markets
Storm in a T-bond

The Bank of Japan
Fukui's fumble

European insurance
Thirst for growth

Hank Paulson
Riddle solved

America's unsung accounting boom
Growth in numbers

Securitising intellectual property
Intangible opportunities

Ranking economic policies
Not quite a row of sixes

Economics focus
Intricate workings

Advertisement

China
Is anyone listening?

Thailand
Long to reign over them

Malaysia
Moaning Mahathir

Australia
No wedding bells

Middle East & Africa

Israel and Palestine
Hamas in a bind

Iraq
A chance for the new man

Nuclear diplomacy with Iran
Make or break?

Kenya
Bling-bling boys from abroad

Zambia
It's looking up a bit

Europe

Georgia, Ukraine and NATO
Surrounding Russia

The Baltics and NATO
Small world

Spain and its regions
Let's all pull apart

Turkey and Armenia
The ties that divide

Ani, a disputed city
Haunted by history

Charlemagne
Could do better

Britain

Fighting child poverty
A long way to go

Poverty line
Head count

Community relations
Who speaks for British Muslims?

London Underground
Mad dogs and Londoners

The NHS and IT
A failure to connect

Corporate pensions
Filling in

Funerals
Pickled

Bagehot
The limits of compassionate conservatism

Articles flagged with this icon are printed only in the British edition of *The Economist*

Science & Technology

Los Alamos National Laboratory
A good enough performance?

How to make a butterfly

AIDS
Nef off

Suicide and antidepressants
Pep pills

Books & Arts

Quai Branly
Gallic grandeur

Maps
Placing names

Twitching on the Tigris
Birds of fray

New fiction
Asymmetric conversions

Doing business in China
China bytes

Obituary

Yasser Talal al-Zahrani

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Immigration

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Derivatives

Emerging-Market Indicators

Overview

Czech Republic

Economy

Financial markets

Advertisement

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Senior Operations Manager, Business Environment
Terms of Reference IFC Private Enterprise Partnership ....

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Business Opportunity - WSI Internet Start Your Own Busines....

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Politics this week

Jun 15th 2006
From The Economist print edition

AP

After a “strategic assessment” at Camp David on the future of **Iraq**, President George Bush flew to Baghdad for a surprise meeting with the new prime minister, Nuri al-Maliki, to whom he promised America's continuing support. See article

The successor to the self-proclaimed leader of al-Qaeda in Iraq, Abu Musab al-Zarqawi, who was killed by American forces last week, was named on an Islamist website as **Abu Hamza al-Muhajir**, a *nom de guerre*, perhaps of an Egyptian jihadist, Abu al-Masri.

Strife in the West Bank and the Gaza Strip increased between the two main **Palestinian** movements, with Fatah loyalists shooting up the Palestinians' parliament and the prime minister's office, which are run by Hamas, while Hamas militants besieged the headquarters of a Fatah-run security force. See article

In separate incidents, an Israeli missile attack on a van in **Gaza** killed two militants and nine civilians; seven Palestinians in one family had earlier been killed by a beach explosion, for which Israel denied responsibility. See article

While **Iran's** president, Mahmoud Ahmadinejad, attended a meeting in Shanghai of six countries (China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan), other governments waited for Iran's response to a package of incentives and penalties offered by several countries, now including America, aimed at persuading it to stop enriching uranium. See article

Islamists who last week captured **Somalia's** capital, Mogadishu, tightened their grip on the southern half of the fragmented country by taking Jowhar, which had served as a temporary capital 90km (55 miles) north of Mogadishu. They now threaten the weak interim government's current seat, north-west at Baidoa.

Britain agreed to hold **Charles Taylor** in prison if the former Liberian leader is convicted of war crimes at his trial in The Hague. The announcement, from Margaret Beckett, Britain's foreign secretary, clears the way for Mr Taylor's trial to begin after several countries refused to host him.

Free again

Abu Bakar Basyir, convicted in March 2005 of conspiracy in connection with the **Bali** bombing in 2002 that killed 202 people, including many Australians, was released from prison. John Howard, Australia's prime minister, said Australians would be “distressed” at the news.

AP

More than 60 people were killed after their bus hit a mine in northern **Sri Lanka**. It was the worst single attack in the country since a “ceasefire” between the government and rebels was agreed in 2002. The armed forces carried out air strikes on suspected Tamil Tiger bases after the incident.

Two people were killed and many injured in a synchronised explosion of 40 small bombs in three Muslim-majority provinces in southern **Thailand**.

China and **Taiwan** agreed to allow non-stop charter flights between their cities, but only during holiday periods.

Amid allegations of corruption against members of his family and officials, **Taiwan's** parliament started hearings aimed at removing President Chen Shui-bian from power. See article

Hoping to join the club

The **European Union** opened the first chapter in formal negotiations over **Turkey's** putative membership. The talks were almost derailed by a veto threat from (Greek) Cyprus. A fudged formula was found to avoid this, but Cyprus could still choose to exercise a veto at any time during the lengthy negotiations that lie ahead.

The **European Commission** gave warning that countries were failing to use the current cyclical upturn to cut their budget deficits. The average deficit in the euro area is still 2.4% of GDP, and several countries are well over the 3% ceiling set by the stability pact.

A senior **Russian** minister proposed tougher restrictions on foreign exploitation of Russian oilfields. Over the past few years the Kremlin has moved steadily to take greater control of Russia's natural resources, especially in energy.

The international boss of the UN-administered province of **Kosovo**, Soren Jessen-Petersen, is resigning early for personal reasons. Sensitive talks on the future status of Kosovo are going on in Vienna. After Montenegro's decision to become independent of Serbia, most Balkan-watchers expect Kosovo to go the same way.

Tie broken

Opinion polls taken after the final campaign debate before **Mexico's** presidential election on July 2nd suggested that Andrés Manuel López Obrador, the left-of-centre former mayor of Mexico City, had edged ahead of his conservative rival, Felipe Calderón.

In **Chile**, hundreds of thousands of schoolchildren ended a three-week boycott of classes after the government agreed to spend nearly $200m on repairing schools, free school lunches and scrapping fees for the university entrance exam.

Suicides at Guantánamo

Reuters

More pressure was put on the United States to close **Guantánamo Bay** after three prisoners hanged themselves. The three, of Middle Eastern origin, were the first detainees at the camp to commit suicide, although there have been dozens of previous attempts. See article

A cloud lifted from the Bush administration when it emerged that **Karl Rove**, George Bush's closest political adviser, will not face charges stemming from the investigation into the leaking of a CIA officer's name. Mr Rove had appeared five times before a grand jury on the matter. See article

Preliminary statistics released by the FBI recorded a 2.5% rise in **violent crime** in 2005, the sharpest since 1991 and a reversal of the annual trend of falling crime rates in the United States. Murders were up in Houston, Las Vegas and Philadelphia, but were down in New York and Los Angeles. See article

Robert Byrd became the longest-serving senator in American history. He was first elected to his West Virginia seat in 1958 and is now campaigning for his ninth term.

The Government Accountability Office estimated that $1 billion (or 16%) of FEMA's disaster relief payments doled out after **Hurricane Katrina** were “improper and potentially fraudulent”. The report also

detailed some misuse of debit cards given to displaced persons, including $200 spent on a bottle of Dom Perignon and $600 at a gentlemen's club.

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Business this week

Jun 15th 2006
From The Economist print edition

Arcelor formally rejected **Mittal Steel's** hostile bid, but held talks to discuss the matter further. Meanwhile, a growing shareholder rebellion at Arcelor threatened to put a spoke in the wheels of its proposed merger with **Severstal**. Alexey Mordashov, the Russian steelmaker's boss, insisted the deal was good for investors and that he would uphold Arcelor's principles of corporate governance. See article

Airbus announced that production "bottlenecks" will result in further delays to deliveries of its A380 super-jumbo. The share price of **EADS**, its parent company, fell by 26% as investors took on board the billions of euros the mess will cost in delay and compensation to dissatisfied airlines. It is the second embarrassing delay to A380 deliveries from the European aeroplane-maker in recent months. See article

The bidding war for **Associated British Ports** began in earnest. A consortium led by **Goldman Sachs**, which had seen its initial bid recommended by ABP's board on June 14th, raised its offer to fend off a rival bid from a consortium led by **Macquarie Bank** (which appealed to ABP's shareholders to ignore Goldman's offer). Both value Britain's biggest port-operator at £2.6 billion ($4.8 billion).

Insuring its future

Credit Suisse agreed to sell **Winterthur**, the insurance business it has been wanting to divest since 2004, to **AXA** for SFr12.3 billion ($10 billion) in cash. AXA will also refinance SFr1.6 billion-worth of Winterthur's debt. See article

Crédit Agricole, France's biggest retail bank, offered to buy **Emporiki**, a Greek bank that is being privatised by the government. The deal, valued at €3.1 billion ($3.9 billion), is a vote of confidence in Greece's rapidly growing economy. But the share price of Alliance & Leicester, a British bank, fell sharply on fears that Crédit Agricole's Greek acquisition may stymie a rumoured merger between the two.

Banco Bilbao Vizcaya Argentaria expanded its retail-banking operations in Texas by buying two more banks in the state. The Spanish bank's acquisitions of **Texas Regional**, which is based in the Rio Grande valley, for which it will pay $2.16 billion, and **State National** ($480m) underscores the growth of remittances from Mexican migrant workers. BBVA, which bought its first Texan bank last year, also owns Bancomer, one of Mexico's largest banks.

Turbo capitalism

After a spate of frenetic share buying that saw it compared to a hedge fund, **Merck** revealed that it had massed a 21.8% stake in **Schering** and was selling it to **Bayer** for €3.7 billion. Bayer, which has offered to buy Schering for €17 billion, so acting as a white knight to fend off a hostile rival bid from Merck, also engaged in some vigorous buying of Schering's shares. The tactics of both firms took watchers of Germany's normally phlegmatic pharmaceuticals sector by surprise. See article

Mirant, a power generator, withdrew its nearly $8 billion bid to buy **NRG Energy**. The offer had been promptly rejected by NRG when it was made in late May, but since then some of Mirant's larger investors, including Pirate Capital, a hedge fund, had also voiced strong opposition to the deal.

A trade commission in the United States is to investigate whether Apple Computer's **iPod** infringes a patent held by Creative Technology, which makes a rival music-player. The news comes shortly after three Nordic countries said they would investigate complaints that the pricing policy of Apple's **iTunes** online music store is anti-competitive.

LG.Philips, the world's biggest maker of large LCD panels, saw its share price fall by 13% on June 13th after it cut its earnings forecast by half for the quarter. Its profits, like those of other flat-panel manufacturers, are being hurt by a sharp decline in the price of big-screen TVs, but the company also said that sales in the run-up to the World Cup were much lower than expected.

More concern from economists that **China's** economy is overheating. Despite official efforts to cool expansion, industrial production rose by 17.9% in the year to May. Meanwhile, China's central bank reported rapid growth in money supply and told banks to “pay close attention” to the risks of lending too much.

All come tumbling down

Stockmarkets around the world fell, primarily over concerns about inflation in America, which increased more sharply than expected in May, and more uncertainty over interest-rate rises. Asian stockmarkets saw some of the biggest losses, as investors worried about the effect of a potential slowdown on exports. As nervousness spread, the price of gold, silver and other commodities also continued their steep declines. See article

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The United States

Inequality and the American Dream

Jun 15th 2006
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The world's most impressive economic machine needs a little adjusting

MORE than any other country, America defines itself by a collective dream: the dream of economic opportunity and upward mobility. Its proudest boast is that it offers a chance of the good life to everybody who is willing to work hard and play by the rules. This ideal has made the United States the world's strongest magnet for immigrants; it has also reconciled ordinary Americans to the rough side of a dynamic economy, with all its inequalities and insecurities. Who cares if the boss earns 300 times more than the average working stiff, if the stiff knows he can become the boss?

Look around the world and the supremacy of “the American model” might seem assured. No other rich country has so successfully harnessed the modern juggernauts of technology and globalisation. The hallmarks of American capitalism—a willingness to take risks, a light regulatory touch and sharp competition—have spawned enormous wealth. “This economy is powerful, productive and prosperous,” George Bush boasted recently, and by many yardsticks he is right. Growth is fast, unemployment is low and profits are fat. It is hardly surprising that so many other governments are trying to “Americanise” their economies—whether through the European Union's Lisbon Agenda or Japan's Koizumi reforms.

Yet many people feel unhappy about the American model—not least in the United States. Only one in four Americans believes the economy is in good shape. While firms' profits have soared, wages for the typical worker have barely budged. The middle class—admittedly a vague term in America—feels squeezed. A college degree is no longer a passport to ever-higher pay. Now politicians are playing on these fears. From the left, populists complain about Mr Bush's plutocratic friends exporting jobs abroad; from the right, nativists howl about immigrants wrecking the system.

A global argument

The debate about the American model echoes far beyond the nation's shores. Europeans have long held that America does not look after its poor—a prejudice reinforced by the ghastly scenes after Hurricane Katrina. The sharp decline in America's image abroad has much to do with foreign policy, but Americanisation has also become synonymous with globalisation. Across the rich world, global competition is forcing economies to become more flexible, often increasing inequality; Japan is one example (see article). The logic of many non-Americans is that if globalisation makes their economy

more like America's, and the American model is defective, then free trade and open markets must be bad.

This debate mixes up three arguments—about inequality, meritocracy and immigration. The word that America should worry about most is the one you hear least—meritocracy.

Begin with inequality. The flip-side of America's economic dynamism is that it has become more unequal—but in a more complex way than first appears (see article). America's rich have been pulling away from the rest of the population, as the returns for talent and capital in a global market have increased. Even if American business stopped at the water's edge, Bill Gates and the partners of Goldman Sachs would still be wealthy people; but since software and investment banking are global industries, Mr Gates is worth $50 billion and the average pay-and-benefits package for Goldman's 22,400 employees is above $500,000.

On the other hand, the current wave of globalisation may not be widening the gap between the poor and the rest. Indeed, the headwinds of the global economy are being felt less by Americans at the bottom than by those in the middle. The jobs threatened by outsourcing—data-processing, accounting and so on—are white-collar jobs; the jobs done by the poor—cleaning and table-waiting, for example—could never be done from Bangalore.

Those at the bottom have different fears, immigration high among them. Their jobs cannot be exported to rival countries perhaps, but rival workers can and are being imported to America. Yet there is surprisingly little evidence that the arrival of low-skilled workers has pulled poor Americans' wages down. And it has certainly provided a far better life for new arrivals than the one they left behind (see article).

A long ladder is fine, but it must have rungs

To many who would discredit American capitalism, this sort of cold-hearted number-crunching is beside the point. Any system in which the spoils are distributed so unevenly is morally wrong, they say. This newspaper disagrees. Inequality is not inherently wrong—as long as three conditions are met: first, society as a whole is getting richer; second, there is a safety net for the very poor; and third, everybody, regardless of class, race, creed or sex, has an opportunity to climb up through the system. A dynamic, fast-growing economy may sometimes look ugly, but it offers far more hope than a stagnant one for everybody in the United States.

This is not to let the American system off the hook when it comes to social mobility. Although the United States is seen as a world of opportunity, the reality may be different. Some studies have shown that it is easier for poorer children to rise through society in many European countries than in America. There is a particular fear about the engine of American meritocracy, its education system. Only 3% of students at top colleges come from the poorest quarter of the population. Poor children are trapped in dismal schools, while richer parents spend ever more cash on tutoring their offspring.

What, if anything, needs to be done? A meritocracy works only if it is seen to be fair. There are some unfair ways in which rich Americans have rewarded themselves, from backdated share options to reserved places at universities for the offspring of alumni. And a few of Mr Bush's fiscal choices are not helping. Why make the tax system less progressive at a time when the most affluent are doing best?

That said, government should not be looking for ways to haul the rich down. Rather, it should help others, especially the extremely poor, to climb up—and that must mean education. Parts of the American system are still magnificent, such as its community colleges. But as countless international league tables show, its schools are not. Education is a political football, tossed about between Republicans who refuse to reform a locally based funding system that starves schools in poor districts, and Democrats who will never dare offend their paymasters in the teachers' unions.

The other challenge is to create a social-welfare system that matches a global business world of fast-changing careers. No country has done this well. But the answer has to be broader than just “trade-adjustment” assistance or tax breaks for hard-hit areas. Health care, for instance, needs reform. America's traditional way of providing it through companies is crumbling. The public pension system, too, needs an overhaul.

These are mightily complicated areas, but the United States has always had a genius for translating the

highfalutin' talk of the American Dream into practical policies, such as the GI Bill, a scholarship scheme for returning troops after the second world war. The country needs another burst of practical idealism. It is still the model the rest of the world is following.

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The logistics revolution

Chain reaction

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A hidden industry has changed all our lives; but some companies are operating rather close to the edge

“THE great manufacturers in the Yorkshire and Lancashire districts tell me that, under modern conditions, they have got into the habit of laying in supply not for a period of two to five months but they are dependent week by week on the importation of the raw material.” So Sir George Parkin described the alarming business practices found in Britain at the dawn of the 20th century. As a leader of the Imperial Federation League, he sought to replace the British empire with a bigger group of trading partners, so as to guarantee supplies. A hundred years on, Sir George would have marvelled at globalisation, but been aghast that today's manufacturers measure their inventories in only a few hours of production.

The great manufacturers now have amazingly lean operations. They have outsourced business to contractors that can do the work more efficiently, often in places where wages are lower. A huge logistics industry has sprung up to move stuff around the world at dazzling speed (see survey).

Containerisation has slashed the cost of shipping. Express air-freight has made overnight delivery possible to most places on earth. Moreover, such services are within the grasp not just of the supply departments of giant multinationals but also of anyone trading on eBay from the spare bedroom. Deliveries have become so reliable that some firms now carry no stock themselves but use the lorries and aircraft of firms like UPS and FedEx as warehouses on the road and in the sky. Many of today's most successful companies, like Wal-Mart, Dell and Toyota, have risen to the top of their industries in large part by rewriting the rules of competition through the organisation of their supply chains.

Chip off the old block

The logistics business is one of the marvels of commerce, but it is not without its risks. Supply chains have become ever more complex and extended. Some great manufacturers (and great service companies) may have become too lean in their relentless drive to reduce costs, outsourcing not just their non-core activities but essential ones too. Relying on just one supplier may boost your buying power, but do you know who is supplying that supplier?

If one link of a company's supply chain snaps, the consequences can be grave. Ericsson and Nokia found

this out when they both relied on the same supplier for a special chip in their mobile phones. After the chipmaker's factory was hit by lightning, Nokia swiftly locked up all the alternative supplies whereas Ericsson suffered a severe parts shortage and later quit making handsets on its own.

A company's best protection from its own supply chain is to expect failure, not to hide from it. Toyota last year narrowly escaped a parts shortage when an American supplier went bankrupt. The carmaker has now introduced an early-warning system in Europe to try to detect any looming problems with suppliers before they bring production lines to a halt.

Sometimes it can be worth paying more to make some things closer to the big consumer markets of America and Europe. Zara, a fast-fashion chain that produces clothes in small batches mostly around its Spanish base, can take just five weeks to get a garment into one of its stores. Stores sourcing from Asia can expect lead times of six months or so, by which time fashions can change. Not surprisingly, Zara ends up discounting fewer of its garments in clearance sales.

Survival tactics

The good news is that many companies are now trying to identify the choke points and weak links in their supply chains. What about Sir George's concern—the wider threat to national economies? With so many people worrying about oil supplies and a bird-flu pandemic, the prospect of supply chains collapsing around the world can seem a scary idea.

It shouldn't be. There are a few industries where it makes sense for governments to keep some emergency stocks of a few essentials such as energy, munitions and medicines. But the logistical apocalypse is not a good way for politicians to think about everyday life, let alone to start interfering in markets. Lean supply chains are more of a strength in an economy than a weakness. Consumers have gained massively from global outsourcing. They pay lower prices and benefit from a huge increase in variety.

Natural disasters are not, in fact, a common cause of supply-chain disruptions. Most are the result of humdrum internal problems, like bad planning or the choice of an unreliable sub-contractor. That can be terrible for a particular company, but hardly poses a threat to society at large. After all, if Ericsson and Nokia cannot supply you with a mobile phone, Samsung would be only too happy to get one to you tomorrow.

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Steel takeovers

Cast-iron

Jun 15th 2006
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The battle for Arcelor is about more than steel

AFP

"MONKEY money" is how Guy Dollé, chief executive of Arcelor, charmingly dismissed a hostile bid earlier this year from Indian-born Lakshmi Mittal, who runs (and largely owns) Mittal Steel. That was the high point of his defence of Europe's biggest steelmaker. Since then Mr Dollé and Arcelor's chairman, Joseph Kinsch, have twisted and turned to escape Mr Mittal. None of their scheming would count as more than two old men's efforts to cling to their jobs, except that shareholders everywhere also have a stake in this fight. For the sake of investors in Europe, what matters is not just who wins Arcelor, but how the battle is resolved.

The steel industry is consolidating. Mr Mittal's €25.8 billion ($32.3 billion) bid would create a huge producer nearly four times the size of its nearest rival. The match, steelmen judged, was a good one. Mittal could expand into Arcelor's high-margin markets, Arcelor could gain from Mittal's low-cost production. But Mr Dollé would have none of it. The offer was "150% hostile", priced too low and strategically misguided. Through management and ownership, the untrustworthy Mittal family would dominate. Although Mittal Steel is registered in the Netherlands and run out of London, it did not in some mysterious way share Arcelor's European "cultural values".

Before long, that nasty little piece of Euro-nationalism was supplemented by opportunism and hypocrisy. First Messrs Dollé and Kinsch bundled Dofasco, a recently acquired Canadian steelmaker, into a holding structure designed to frustrate Mittal's plans to sell it on—a poison pill, if ever there was one. Next they proposed to scotch Mittal by merging with Severstal, an opaque metals firm controlled by a Russian tycoon who, without launching a bid, was to become the dominant shareholder of the combined group. So much for Mr Dollé's superior standards of corporate governance.

The victims in all this are Arcelor's own shareholders—something that should worry investors in Europe. All along, Messrs Kirsch and Dollé have denied their own shareholders a proper shout. Investors had no say over Dofasco and they can stall the Severstal deal only if at least half of the shareholder register rejects the merger at a meeting in Luxembourg at the end of this month (see article). The threshold for such votes is usually a simple majority of those present: Arcelor's hurdle looks as if it was erected to be insurmountable.

Arcelor insists it has done nothing wrong. Its articles of association and the law of Luxembourg, where it

is incorporated, would allow the Severstal deal without any shareholder vote at all. Mittal has already raised its offer once and Mr Dollé says he is open to further offers that are higher still.

My company right or wrong

That is disingenuous. Whether Mittal or Severstal would most benefit Arcelor shareholders is open to argument. Most analysts favour Mittal's improved offer, but Arcelor's board this weekend judged, as it is entitled to, the Russian deal to be better. The way to decide between the two is for Arcelor's shareholders to have a fair vote. It is their company, after all.

That is the principle at stake here—and a good reason to hope that Arcelor investors now rush to sell their shares in the market to Mr Mittal, giving him the majority he needs. Managers are entitled to use the rules to push up a bidder's price and protect their company. But if they exploit the rules against their own shareholders' interests, by seeking to deprive investors of a choice, then the essential covenant between owner and manager is broken, whatever the small print. If Arcelor's managers get away with flouting that principle, shareholders everywhere in Europe will be the losers.

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Whaling

Too much blubber

Jun 15th 2006
From The Economist print edition

It is time to look rationally at the idea of resuming whaling

EPA

“NUKE the whales” was the message on a badge once popular with those tired of the self-righteous posturing of the extreme wing of the environmental movement. It has not come to that. But a subtler threat to the great beasts is afoot. Japan wants to resume commercial whaling—and it may eventually get permission to do so.

Japan is accused of buying votes on the International Whaling Commission, the body that regulates the whaling industry, which is starting its annual meeting on June 16th in St Kitts. Founded in 1948 by seven countries with large whaling fleets, namely America, Australia, Britain, France, Norway, South Africa and the Soviet Union, the commission has attracted some odd members recently. Many of them are small places with no history of whaling: Kiribati, the Marshall Islands and St Kitts itself, for example. Several, such as Hungary, Mali, Mongolia and Switzerland, are landlocked. What many of these new members have in common is that they are recipients of Japanese aid money. Some are even said to have had their subscriptions to the commission paid by Japan.

Environmentalists are up in arms. In 1986 the commission agreed to a moratorium on commercial whaling (though Norway opted out). Overturning this moratorium is Japanese government policy. At the moment, it does not have enough support to do so (three-quarters of the commission's 70 members would have to be in favour) but Japanese officials believe their country has enough allies at this year's meeting to make some progress. In particular, Japan is suggesting that future ballots should be secret. Winning that change would require only a simple majority, and with secret voting waverers might be more ready to vote Japan's way in future.

Yet all this criticism of underhand tactics rests on an untested assumption—that the moratorium should not be lifted. Is that assumption correct? The moratorium has certainly been a success. Whale numbers are rising. Even the blue whale, the largest mammal, is recovering slowly. Some humpback-whale populations are growing at 7% a year. And no one, not even the Japanese, is talking about resuming hunting still-rare blue whales or humpbacks just yet.

Yet the commission's convention is clear: its purpose is to conserve whales in the context of a commercial fishery, not because they are “charismatic megafauna” that should be preserved for their own sake. In this context, it is perfectly reasonable for Japan to want to re-examine the moratorium.

Conscious decisions

The idea of charismatic megafauna hardly existed in 1948. There needs to be an honest debate about how humanity should treat whales. Both sides muddy the waters. Conservationists protest about the methods used to kill whales, saying they are cruel. They might be, but that is not the point, unless there really is a lobby that would accept the humane killing of whales. On the other side, the Japanese and their Icelandic allies hunt minke whales, which are still reasonably abundant, under the guise of scientific research. In practice, this is commercial fishing with a side order of science.

Should whales be treated like any other type of animal which some humans want to hunt, namely protected when rare, but hunted when common? Or is there something special about them that means that they should never be hunted? Biologists have come to recognise that great apes (chimpanzees, gorillas and so on) have mental faculties of self-awareness and consciousness that they share with humans but that neither shares with, say, monkeys. A few other big-brained social mammals, such as elephants, are thought by some to have evolved similar capacities. Whales may be among these species. Some places—Spain, for example—are discussing changing the law to recognise this distinction in apes. But on whales, there are no data.

In the absence of data, the commission should stick to its brief. But here is a suggestion: put the whole thing on a proper economic basis. The Japanese fleet is heavily subsidised. Without government cash, there would be less enthusiasm to hunt a creature ever fewer Japanese want to eat. Sadly the commission has no remit over that; but, if it does vote to resume commercial whaling (as it has the right to do), it should not create a system of quotas allocated by country. Instead, it should put whale-hunting rights up for auction, allowing both killers and conservationists to bid. The chances are that those who prefer whales to swim free would be able to outbid the few remaining humans who like eating them.

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Israel and Palestine

The Hamas conundrum

Jun 15th 2006
From The Economist print edition

There is no easy path towards peace, but Hamas cannot yet be wished away

AFP

Get article background

THE plight of the Palestinians goes from bad to worse. They are being hammered from every direction—by Israelis, by the West and by each other. The Americans, the European Union and their closest Arab allies in effect refuse to give them succour for fear of fortifying their Islamist Hamas government because it refuses, among other things, to eschew violence and recognise Israel's right to exist (see article).

The inhabitants of the Gaza Strip are caught in a maelstrom of internecine feuding between gunmen of Hamas and its Fatah rivals, loth to accept the electoral defeat they suffered earlier this year. As assorted Palestinian militants continue to fire rockets into southern Israel, hapless Palestinian civilians are killed in the middle. Assassinations by Israelis of alleged terrorists habitually kill nearby women and children. Last week, a Palestinian girl became another heart-rending icon of this ancient tragedy when an explosion at a beach picnic killed at least seven members of her family; few Palestinians believe Israel's pained insistence it was not responsible.

Amid such mayhem, it is hard to imagine that things may get worse. But they may. As a result of the latest round of tit-for-tat violence, Hamas says it is ending its 16-month-old truce, during which it has suspended suicide-bombings in Israel. The spectre of a return to widespread Palestinian suicide-bombings and a third *intifada* looms. That would be a disaster.

What little hope now exists of early negotiations towards the hoped-for solution of two separate states living side by side in peace would then fizzle altogether. A new *intifada* might well make it impossible for Israel's new prime minister, Ehud Olmert, to move forward with the plan he has been touting lately to mixed reviews in America and Europe. A negotiated peace is best, he says. But if negotiations fail, Israel will give up most of its smaller West Bank settlements and redraw its borders unilaterally around the bigger settlements.

Stop the killing and lift the siege

To prevent a further slide into chaos, two things must be done right away. The first is to nip the rising violence in the bud. That should not be as difficult as it sounds. The main instigators of the recent

exchanges have not been Hamas itself but smaller groups such as Islamic Jihad, which have taken it upon themselves to fire rockets into southern Israeli towns ever since the Israelis evacuated the Gaza Strip last year. That has provoked Israeli counter-fire, which is now in danger of drawing Hamas into a new round against Israel. If Hamas's leaders expect to be treated as a responsible government—and to avoid being drawn into a fight with Israel that they do not at present want—they need to stop these pointless cross-border provocations. Power, as the outside world keeps telling Hamas, means accepting responsibilities too.

In parallel with this, however, a second duty falls on those outsiders. The rest of the world needs to accept that Hamas is indeed the legitimate, elected government of Palestine. The Americans say they do accept this. But they have also led an international boycott and economic siege of the new government. Their stated aim is to force Hamas to accept Israel's right to exist and return the Palestinians to the negotiating table. But inside the occupied territories America's actions are seen as an attempt to hobble or even destroy the duly elected government, hoping that Mr Abbas and his more malleable Fatah friends will then return to power.

If this is the American design, it seems doomed to fail. A diplomatic boycott is one thing, but the Palestinians cannot and should not be starved into a humiliating reversal of their democratic choice. Western governments are understandably reluctant to see their taxpayers' money funnelled into a Palestinian administration that still rejects Israel and has a recent history of terrorism. But some way must nonetheless be found to send in aid and avert a humanitarian crisis in the occupied territories. The more desperate the Palestinians become, the less ready they will be to compromise.

And compromise is still possible. Hamas has a pragmatic side, which may still come to the fore as its leaders realise the need to be flexible if they want to stay in office. Some leading lights in Hamas have floated, in a non-committal way, the possibility of a two-state solution, if Palestinians endorsed the idea in a referendum. Mr Abbas is now pushing for such a referendum. For the moment, Hamas rejects the idea as a trick for Mr Abbas and his foreign friends to undermine the elected government. But if violence ends and passions cool, it may yet be a way of nudging Hamas towards a new realism.

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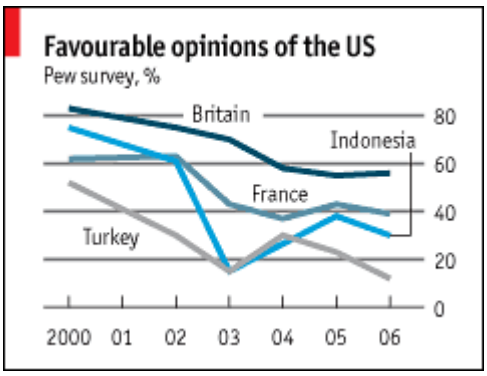
America's war for hearts and minds

Mind your language

Jun 15th 2006
From The Economist print edition

A little politeness goes a long way



IT SEEMS unfair to single out the hapless Colleen Graffy. America's deputy assistant secretary for public diplomacy is far from being the only official in George Bush's administration who has a tin ear when it comes to—well, to public diplomacy. When three of the Muslim inmates held for years without trial at Guantánamo in Cuba hanged themselves last weekend, she called this "a good PR move". But she was hardly alone in sounding callous. The commander of Guantánamo, a sensitive soul, grumbled that by hanging themselves his three charges had committed an act of "asymmetrical warfare" against the United States. Plenty more tin ears and sharp tongues belong to bigger heads higher up in the administration.

Inside the clever head of Donald ("stuff happens") Rumsfeld, America's defence secretary, for example, wags a tongue that may on its own be responsible for having needlessly alienated more former friends of the United States than any other instrument since the invention of the B-52 bomber. As for John Bolton, America's ambassador to the United Nations, he appears to take particular pride in ignoring the advice of the Founding Fathers for America to pay a decent respect to the opinions of mankind. Mr Bolton is trying to force various management reforms through the UN's glass palace in New York. Reform is sorely needed. But instead of using persuasion, Mr Bolton too often plays the bully. His tone is that America is *numero uno*, the UN's chief paymaster, and so must be obeyed. Some potential allies are put off.

To his credit, Mr Bush himself has been learning. Under the civilising influence of Condoleezza Rice, a secretary of state who took up her job intent on putting the diplomacy back into American foreign relations, Mr Bush has lately been politer about other countries, and readier to admit some of his own mistakes. He now says he wants Guantánamo closed—just as soon as America figures out what to do with all the people it has scooped up and dumped in legal limbo there.

But in some ways the president still doesn't get it. Take something that went down well in America—Mr Bush's surprise call this week on the new prime minister of Iraq. Nuri al-Maliki had been building up the elected government's credibility by putting a careful distance between himself and the Americans. The last thing he needs is to look like the superpower's stooge. But he seems to have been given no advance notice of the visit. After Mr Bush was choppered into Baghdad, a bemused Mr Maliki was obliged to stand squirming alongside his beaming visitor, as pictures of president and stooge were flashed unhelpfully to Muslims in Iraq and around the world. It is sometimes bad manners to drop in uninvited.

Manners maketh multilateralism

Manners and tone of voice matter in international relations. Go back to those suicides. Though Ms Graffy ought not to have called them a good PR stunt, she may have been right to imply that they were a political act, rather than individual expressions of despair (see obituary). The point, though, is that if much of the war against terrorism is a contest between values—in short, a PR war—America should be winning hands down. A brand that stands for life, liberty and the pursuit of happiness is an easier sell than a brand that stands for beheading unbelievers and reviving the Middle Ages.

And yet America is not doing half as well as it should be. The annual Pew survey of global attitudes this

week reports yet another fall in its standing almost everywhere. Why? In part, because actions speak louder than words, and America sometimes betrays its own values. The Guantánamo inmates should be tried or released. In part because some American actions are right but unpopular. America should, for example, stay in Iraq until the new government can stand alone. But also because of those tin ears and sharp tongues. That problem cannot be fixed by hiring “public diplomacy” experts. Mr Bush needs to remind his top people that, especially in a superpower, a little politeness goes a long way.

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On America and Israel, Europe, Slovakia, Haditha, Indonesia, petrol prices, Alberta, American unions

Jun 15th 2006
From Economist.com

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FAX: 020 7839 2968 E-MAIL: letters@economist.com

Israel and America

SIR – The analysis that Israel's Ehud Olmert did not receive everything he hoped for from George Bush on his recent trip to the United States seems to be correct ("Yes, but", May 27th). However, I was heartened by the president's affirmation of a negotiated two-state solution and I hope he follows this by providing energetic leadership to move toward that goal. The United States would thus further its other national security goals in the Middle East, specifically by increasing support in the Muslim world for our objectives of fighting terrorism, rebuilding Iraq, preventing Iran from getting nuclear weapons and promoting democracy in the region. In the face of growing regional instability, the assertion of American leadership in the Israeli-Palestinian conflict is perhaps more important than ever—for all parties involved.

William Harrop
Former United States ambassador to Israel
Washington, DC

Euro-vision

SIR – Your leader on the future of the European Union was, sadly, no exception to a debate that is too often conducted by soundbite ("Stuck in the doldrums", May 27th). For a start, your claim that "the European project has been carried forward by an elite that has paid little heed to the views of ordinary people" parrots a Eurosceptic cliché with no foundation. No other political issue has been subject to so many referendums in so many countries as the process of European integration. And as regards the constitutional treaty, it is again far too simple to imply that it has been rejected by "the people". Rather, it is a question of divergence, with the French and Dutch having said no, but others saying yes (in total, more have voted yes than no) and a majority of member states having ratified it. If you are serious about the EU having the capacity to preserve the single market, then it is essential to strengthen its capacity to act effectively and democratically. This means supporting, not rubbishing, attempts to overcome divergence on the treaty and finding a solution that takes account both of the concerns of those who oppose it and of the majority who support it.

Richard Corbett MEP
Deputy leader of the European Parliamentary Labour Party
Leeds

Not-so-super structure

SIR – The only things that are new about Bratislava's New Bridge are the retro-style bucket urinals at its restaurant ("A tale of two Slavic states", June 3rd). It was therefore misleading to use a picture of the bridge to depict the "new Slovakia" in your article. This widely despised monstrosity from the bad old Commie days was completed in 1972 after an entire section of the Old Town had been bulldozed to make way for its glory.

Robert La Bua
Sydney

A rush to judgment?

SIR – Your stance on the allegations of a massacre in Haditha lacked the objective and reasoned quality I expect from *The Economist* ("The massacre in Haditha", June 3rd). As a marine and as an American, I found your demonisation of American forces to be insulting and dangerous. You said that "final judgment should be reserved", but then pronounced judgment on "marines kicking down doors and murdering men, women and children" as perpetrators of "the massacre in Haditha". You disparaged America and the Marine Corps and encouraged terrorists, all on the basis of allegations and hearsay. I would hate to see what you have in store if any of the accusations prove truthful.

Sam Moore
Richmond, Virginia

SIR – The murder of civilians in Haditha will test suspicions about America's rationale for not joining the International Criminal Court. George Bush has vowed to punish any marine found guilty of breaking the law at Haditha and one only hopes that the system will cope better than during the Vietnam war. Following Lieutenant William Calley's murder conviction for his part in the My Lai massacre, Richard Nixon ordered his release pending an appeal and he ultimately served a sentence of less than four years.

Steve Long
Oakland, California

Dissenting views

SIR – It is right to criticise Indonesia's current president, Susilo Bambang Yudhoyono, for failing to bring to justice those officers who committed atrocities against Papuan separatists ("An understated success", May 27th). But you failed to mention the many Papuan peaceful demonstrators who have been sent to prison since Suharto's fall in 1998. These include Filep Karma and Yusak Pakage, convicted of treason for raising a flag. Until the new president can guarantee freedom of expression and peaceful protest, Indonesia will not have broken fully with the Suharto era.

Avi Bram
Maidenhead, Berkshire

Driving range

SIR – An attempt to blame the dynamics of supply and demand for high petrol prices in America neglects the role of politicians, who caved in to carmakers years ago and failed to raise car-emissions standards ("Much ado about pumping", June 3rd). Although firms like Ford and General Motors may have been ecstatic about this in the past, they are now paying dearly for not being compelled to make more efficient SUVs (as are the middle-class families that bought them). And if you want to talk about market dynamics at the pump, then look no further than the increase in demand for hybrid cars, which can increase fuel efficiency over other mid-sized cars with the help of an electric engine. Maybe if politicians had raised efficiency standards sooner, they would not be out on the stump talking about a crisis now.

D.J. Jacobs
New York

SIR – I have lived all over the United States and can safely say that ordinary Americans are lazy when it comes to public transportation, which they do not use because they think it inefficient, expensive and for the poor. People should walk and bike more and quit pointing a finger at the rising cost of petrol and instead poke at the huge gut they develop from driving two blocks just to pick up a carton of milk.

Carleton Peck
El Cerrito, California

Café culture observations

SIR – A debate over your musings that fewer women are looking for work in Alberta because of either kitchen-bound social conservatism or their husbands' "hefty paycheques" could be influenced by the time of day ("Help wanted", May 27th). An early morning pause at a trendy coffee shop in Calgary could lead

one to conclude that female executives are as common as the luxury cars on the street outside. Conversely, a return to the same establishment in mid-afternoon (just after yoga class) would place one in the path of a squadron of obnoxious trophy wives. Neither group, however, is likely to be receptive to any discussion of kitchens that would be so bold as to stray from the topic of expensive renovations.

Glenn Farn
Calgary, Canada

ONLINE ARTICLES

The following correspondence refers to articles published only online

American trade unions

SIR - Your article on American trade unions wrongly characterises right-to-work laws as "anti-union". ("The shrinking power of America's unions", June 12th, Global Agenda). In fact, they simply make union membership and payment of dues optional. If laws respecting freedom of association of workers are anti-union then so was Samuel Gompers, founder of the American Federation of Labour. He argued passionately that everyone should have the right to join a union but no one should ever be forced.

If union membership is of value to workers, they will join without coercion. Like Gompers, the National Right to Work Foundation believes that employees ought to be able to control their unions, not the other way around.

Stefan Gleason
Vice-president
National Right to Work Foundation
Springfield, Virginia

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Inequality in America

The rich, the poor and the growing gap between them

Jun 15th 2006 | WASHINGTON, DC
From The Economist print edition

The rich are the big gainers in America's new prosperity

Getty Images

AMERICANS do not go in for envy. The gap between rich and poor is bigger than in any other advanced country, but most people are unconcerned. Whereas Europeans fret about the way the economic pie is divided, Americans want to join the rich, not soak them. Eight out of ten, more than anywhere else, believe that though you may start poor, if you work hard, you can make pots of money. It is a central part of the American Dream.

The political consensus, therefore, has sought to pursue economic growth rather than the redistribution of income, in keeping with John Kennedy's adage that “a rising tide lifts all boats.” The tide has been rising fast recently. Thanks to a jump in productivity growth after 1995, America's economy has outpaced other rich countries' for a decade. Its workers now produce over 30% more each hour they work than ten years ago. In the late 1990s everybody shared in this boom. Though incomes were rising fastest at the top, all workers' wages far outpaced inflation.

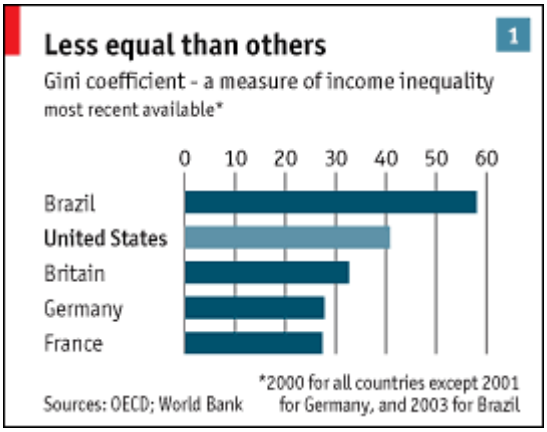
But after 2000 something changed. The pace of productivity growth has been rising again, but now it seems to be lifting fewer boats. After you adjust for inflation, the wages of the typical American worker—the one at the very middle of the income distribution—have risen less than 1% since 2000. In the previous five years, they rose over 6%. If you take into account the value of employee benefits, such as health care, the contrast is a little less stark. But, whatever the measure, it seems clear that only the most skilled workers have seen their pay packets swell much in the current economic expansion. The fruits of productivity gains have been skewed towards the highest earners, and towards companies, whose profits have reached record levels as a share of GDP.

Even in a country that tolerates inequality, political consequences follow when the rising tide raises too few boats. The impact of stagnant wages has been dulled by rising house prices, but still most Americans are unhappy about the economy. According to the latest Gallup survey, fewer than four out of ten think it is in “excellent” or “good” shape, compared with almost seven out of ten when George Bush took office.

The White House professes to be untroubled. Average after-tax income per person, Mr Bush often points out, has risen by more than 8% on his watch, once inflation is taken into account. He is right, but his claim is misleading, since the median worker—the one in the middle of the income range—has done less well than the average, whose gains are pulled up by the big increases of those at the top.

Privately, some policymakers admit that the recent trends have them worried, and not just because of the congressional elections in November. The statistics suggest that the economic boom may fade. Americans still head to the shops with gusto, but it is falling savings rates and rising debts (made possible by high house prices), not real income growth, that keep their wallets open. A bust of some kind could lead to widespread political disaffection. Eventually, the country's social fabric could stretch. “If things carry on like this for long enough,” muses one insider, “we are going to end up like Brazil”—a country notorious for the concentration of its income and wealth.

America is nowhere near Brazil yet (see chart 1). Despite a quarter century during which incomes have drifted ever farther apart, the distribution of wealth has remained remarkably stable. The richest Americans now earn as big a share of overall income as they did a century ago (see chart 2), but their share of overall wealth is much lower. Indeed, it has barely budged in the few past decades.



The elites in the early years of the 20th century were living off the income generated by their accumulated fortunes. Today's rich, by and large, are earning their money. In 1916 the richest 1% got only a fifth of their income from paid work, whereas the figure in 2004 was over 60%.

The not-so-idle rich

The rise of the working rich reinforces America's self-image as the land of opportunity. But, by some measures, that image is an illusion. Several new studies* show parental income to be a better predictor of whether someone will be rich or poor in America than in Canada or much of Europe. In America about half of the income disparities in one generation are reflected in the next. In Canada and the Nordic countries that proportion is about a fifth.

It is not clear whether this sclerosis is increasing: the evidence is mixed. Many studies suggest that mobility between generations has stayed roughly the same in recent decades, and some suggest it is decreasing. Even so, ordinary Americans seem to believe that theirs is still a land of opportunity. The proportion who think you can start poor and end up rich has risen 20 percentage points since 1980.

That helps explain why voters who grumble about the economy have nonetheless failed to respond to class politics. John Edwards, the Democrats' vice-presidential candidate in 2004, made little headway with his tale of “Two Americas”, one for the rich and one for the rest. Over 70% of Americans support the abolition of the estate tax (inheritance tax), even though only one household in 100 pays it.

Americans tend to blame their woes not on rich compatriots but on poor foreigners. More than six out of ten are sceptical of free trade. A new poll in *Foreign Affairs* suggests that almost nine out of ten worry about their jobs going offshore. Congressmen reflect their concerns. Though the economy grows, many have become vociferous protectionists.

Other rich countries are watching America's experience closely. For many Europeans, America's brand of capitalism is already far too unequal. Such sceptics will be sure to make much of any sign that the broad middle-class reaps scant benefit from the current productivity boom, setting back the course of European reform even further.

The conventional tale is that the changes of the past few years are simply more steps along paths that began to diverge for rich and poor in the Reagan era. During the 1950s and 1960s, the halcyon days for America's middle class, productivity boomed and its benefits were broadly shared. The gap between the lowest and highest earners narrowed. After the 1973 oil shocks, productivity growth suddenly slowed. A

few years later, at the start of the 1980s, the gap between rich and poor began to widen.

The exact size of that gap depends on how you measure it. Look at wages, the main source of income for most people, and you understate the importance of health care and other benefits. Look at household income and you need to take into account that the typical household has fallen in size in recent decades, thanks to the growth in single-parent families. Look at statistics on spending and you find that the gaps between top and bottom have widened less than for income. But every measure shows that, over the past quarter century, those at the top have done better than those in the middle, who in turn have outpaced those at the bottom. The gains of productivity growth have become increasingly skewed.

If all Americans were set on a ladder with ten rungs, the gap between the wages of those on the ninth rung and those on the first has risen by a third since 1980. Put another way, the typical worker earns only 10% more in real terms than his counterpart 25 years ago, even though overall productivity has risen much faster. Economists have long debated why America's income disparities suddenly widened after 1980. The consensus is that the main cause was technology, which increased the demand for skilled workers relative to their supply, with freer trade reinforcing the effect. Some evidence suggests that institutional changes, particularly the weakening of unions, made the going harder for people at the bottom.

Whether these shifts were good or bad depends on your political persuasion. Those on the left lament the gaps, often forgetting that the greater income disparities have created bigger incentives to get an education, which has led to a better trained, more productive workforce. The share of American workers with a college degree, 20% in 1980, is over 30% today.

The excluded middle

In their haste to applaud or lament this tale, both sides of the debate tend to overlook some nuances. First, America's rising inequality has not, in fact, been continuous. The gap between the bottom and the middle—whether in terms of skills, age, job experience or income—did widen sharply in the 1980s. High-school dropouts earned 12% less in an average week in 1990 than in 1980; those with only a high-school education earned 6% less. But during the 1990s, particularly towards the end of the decade, that gap stabilised and, by some measures, even narrowed. Real wages rose faster for the bottom quarter of workers than for those in the middle.

After 2000 most people lost ground, but, by many measures, those in the middle of the skills and education ladder have been hit relatively harder than those at the bottom. People who had some college experience, but no degree, fared worse than high-school dropouts. Some statistics suggest that the annual income of Americans with a college degree has fallen relative to that of high-school graduates for the first time in decades. So, whereas the 1980s were hardest on the lowest skilled, the 1990s and this decade have squeezed people in the middle.

Getty Images

First, pick your parents

The one truly continuous trend over the past 25 years has been towards greater concentration of income at the very top. The scale of this shift is not visible from most popular measures of income or wages, as

they do not break the distribution down finely enough. But several recent studies have dissected tax records to investigate what goes on at the very top.

The figures are startling. According to Emmanuel Saez of the University of California, Berkeley, and Thomas Piketty of the Ecole Normale Supérieure in Paris, the share of aggregate income going to the highest-earning 1% of Americans has doubled from 8% in 1980 to over 16% in 2004. That going to the top tenth of 1% has tripled from 2% in 1980 to 7% today. And that going to the top one-hundredth of 1%—the 14,000 taxpayers at the very top of the income ladder—has quadrupled from 0.65% in 1980 to 2.87% in 2004.

Put these pieces together and you do not have a picture of ever-widening inequality but of what Lawrence Katz of Harvard University, David Autor of the Massachusetts Institute of Technology and Melissa Kearney of the Brookings Institution call a polarisation of the labour market. The bottom is no longer falling behind, the top is soaring ahead and the middle is under pressure.

Superstars and super-squeezed

Can changes in technology explain this revised picture? Up to a point. Computers and the internet have reduced the demand for routine jobs that demand only moderate skills, such as the work of bank clerks, while increasing the productivity of the highest-skilled. Studies in Britain and Germany as well as America show that the pace of job growth since the early 1990s has been slower in occupations that are easy to computerise.

For the most talented and skilled, technology has increased the potential market and thus their productivity. Top entertainers or sportsmen, for instance, now perform for a global audience. Some economists believe that technology also explains the soaring pay of chief executives. One argument is that information technology has made top managers more mobile, since it no longer takes years to master the intricacies of any one industry. As a result, the market for chief executives is bigger and their pay is bid up. Global firms plainly do compete globally for talent: Alcoa's boss is a Brazilian, Sony's chief executive is American (and Welsh).

But the scale of America's income concentration at the top, and the fact that no other country has seen such extreme shifts, has sent people searching for other causes. The typical American chief executive now earns 300 times the average wage, up tenfold from the 1970s. Continental Europe's bosses have seen nothing similar. This discrepancy has fostered the “fat cat” theory of inequality: greedy businessmen sanction huge salaries for each other at the expense of shareholders.

Whichever explanation you choose for the signs of growing inequality, none of the changes seems transitory. The middle rungs of America's labour market are likely to become ever more squeezed. And that squeeze feels worse thanks to another change that has hit the middle class most: greater fluctuations in people's incomes.

The overall economy has become more stable over the past quarter century. America has had only two recessions in the past 20 years, in 1990-91 and 2001, both of which were mild by historical standards. But life has become more turbulent for firms and people's income now fluctuates much more from one year to the next than it did a generation ago. Some evidence suggests that the trends in short-term income volatility mirror the underlying wage shifts and may now be hitting the middle class most.

What of the future? It is possible that the benign pattern of the late 1990s will return. The disappointing performance of the Bush era may simply reflect a job market that is weaker than it appears. Although unemployment is low, at 4.6%, other signals, such as the proportion of people working, seem inconsistent with a booming economy.

More likely, the structural changes in America's job market that began in the 1990s are now being reinforced by big changes in the global economy. The integration of China's low-skilled millions and the increased offshoring of services to India and other countries has expanded the global supply of workers. This has reduced the relative price of labour and raised the returns to capital. That reinforces the income concentration at the top, since most stocks and shares are held by richer people. More important, globalisation may further fracture the traditional link between skills and wages.

As Frank Levy of MIT points out, offshoring and technology work in tandem, since both dampen the

demand for jobs that can be reduced to a set of rules or scripts, whether those jobs are for book-keepers or call-centre workers. Alan Blinder of Princeton, by contrast, says that the demand for skills depends on whether they must be used in person: X-rays taken in Boston may be read by Indians in Bangalore, but offices cannot be cleaned at long distance. So who will be squeezed and who will not is hard to predict.

The number of American service jobs that have shifted offshore is small, some 1m at the most. And most of those demand few skills, such as operating telephones. Mr Levy points out that only 15 radiologists in India are now reading American X-rays. But nine out of ten Americans worry about offshoring. That fear may be enough to hold down the wages of college graduates in service industries.

All in all, America's income distribution is likely to continue the trends of the recent past. While those at the top will go on drawing huge salaries, those in the broad middle of the middle class will see their incomes churned. The political consequences will depend on the pace of change and the economy's general health. With luck, the offshoring of services will happen gradually, allowing time for workers to adapt their skills while strong growth will keep employment high. But if the economy slows, Americans' scepticism of globalisation is sure to rise. And even their famous tolerance of inequality may reach a limit.

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About sponsorship

Immigration and "The Jungle"

Of meat, Mexicans and social mobility

Jun 15th 2006 | LUMBERTON, NORTH CAROLINA
From The Economist print edition

Among the very poor, the American Dream is alive and well

AP

A HUNDRED years ago, a sensational novel attacking the meatpacking industry prompted Congress to draft the first federal food-safety laws. The author of "The Jungle", Upton Sinclair, was disappointed. He had hoped to persuade Americans to embrace socialism. For him, the important point was not that the slaughterhouses of Chicago were unsanitary, but that they were "the spirit of capitalism made flesh"—a system in which "a hundred human lives did not balance a penny of profit." The book's central character, a Lithuanian named Jurgis Rudkus, had come to America believing that through hard work he could grasp the American Dream. But he found that "the whole country...was nothing but one gigantic lie."

Rarely has a great novelist been so wrong about so much. No one now worries about the poverty of Lithuanian-Americans. But many still worry about the health of the American Dream. Can immigrants still work their way up from the bottom? Can they become American?

Many fear that, for the latest wave of mostly-unskilled immigrants from Latin America, the answer is no. Some fret that the newcomers are too ill-educated and culturally alien to prosper or assimilate. Others are convinced that immigrant workers are horribly exploited or trapped forever in low-wage jobs. Both worries are largely unfounded.

Consider Alberto Queiroz, who crept across the border 12 years ago. After a stuffy ride in the boot of a car, he found his first job in a Chinese-owned clothes factory in Los Angeles. Workers with papers were paid the minimum wage, he recalls. Having none, he had to make do with $2.50 an hour. Though unlawfully stingy, this was much better than he could have earned back home in Mexico.

After two years he moved to North Carolina, a state that was then just starting to become a magnet for Mexicans. He picked blueberries for $5 a box, earning nearly $100, tax free, for a 12-hour day. But this job lasted only two months, until the harvest ended. So he sought more stable employment, which he eventually found at America's largest hog slaughterhouse.

Smithfield Foods' plant at Tar Heel, North Carolina, turns some 32,000 pigs a day into hams and loins. Thanks to selective breeding and efficient, hygienic processing, American meat has grown steadily

leaner, cheaper and safer, says Joe Luter, Smithfield's chairman. A hundred years ago, food ate up half of Americans' take-home pay; now it is only about a tenth, and no one gets trichinosis from Mr Luter's pork chops.

But is a slaughterhouse a nice place to work? Smithfield does not let journalists in, for reasons of “biosecurity”. Human Rights Watch, a watchdog from New York, issued a report in 2004 entitled “Blood, Sweat and Fear”, which accused American meat and poultry firms of “systematic human-rights violations”. Slaughterhouses are harsh and dangerous places to work, said the report, and illegal immigrants, who form a large chunk of the workforce, find it hard to defy abusive employers.

Mr Queiroz takes a more benign view. Yes, the work is hard. The line goes fast and you have to keep cutting till your hands are exhausted. And yes, it is sometimes dangerous. He says he once saw a co-worker lose a leg when he ducked under the disassembly line instead of walking round it. But many occupations are risky. Taxi-drivers are 34 times more likely to die on the job than meatpackers.

Mr Queiroz does not think Smithfield was a bad employer. Wages of more than $10 an hour enabled him to buy a house back in Mexico. Cutting up pigs was easier than picking blueberries, he says, because he did not have to toil under the sun all day. And when he had had enough, he quit and set up a taco stand with his brother. That was five years ago. Now he owns a Mexican restaurant. America, he says, is “the land of opportunity”.

The meatpacking industry has changed dramatically since Sinclair's day, when pigs and cattle were transported live to city stockyards so that the meat would still be edible when city-dwellers bought it. Now, thanks to better roads and refrigerated trucks, there is no need to build slaughterhouses near where customers live. No pigs have been slaughtered in Chicago for years. Firms like Smithfield now favour rural sites, where rents and wages are lower. And the immigrant workforce is largely Hispanic, since Jurgis Rudkus's great-grandchildren prefer to work in offices.

Those market signals

News about jobs spreads quickly through the Hispanic grapevine. The shift of meatpackers to the countryside is one of many market signals attracting immigrants to different parts of America. New migrants head not only for California, New York, Texas and Florida, but also for Georgia, Arizona, Arkansas and Oregon. Perhaps the most rapid change has taken place in North Carolina, where a technology and construction boom has sucked in hundreds of thousands of migrant workers, swelling the Hispanic population by more than 1,000% since 1990.

In some areas, the newcomers strain local services. Cindy Evans, director of a county clinic for children in Raleigh, says the percentage of her patients who are Hispanic has leapt from perhaps 2% a decade and a half ago to about 65%. The clinic is full of bilingual signs. Next to one, someone has scrawled: “Speak English!”.

Many native-born North Carolinians are uneasy about the pace at which their state has Latinised. Few of the newcomers arrived legally. Some join gangs. As in the rest of America, antipathy towards illegal immigrants, though widespread, is mostly mild and seldom violent. It should not be dismissed, however, since it is politically influential. In Washington, Congress is still struggling to reconcile rival immigration reforms—a House bill that cracks down on illegals and a Senate bill that offers them a path to citizenship. Throughout the country, populists echo and stoke their constituents' anxieties.

Fear of immigration is akin to fear of globalisation. Unemployment may be low, but many Americans fear losing their jobs to someone cheaper in Bangalore, or someone who took the bus up from Tijuana. Meanwhile, the benefits of immigration, like those of globalisation, are often taken for granted. “Americans just assume they can have a pizza delivered for $9,” says Federico van Gelderen, a Raleigh-based executive for Univision, a Spanish-language television station.

Accurately measuring the economic consequences of immigration is hard. Looking only at North Carolina, John Kasarda and James Johnson recently found that Latinos paid $756m in taxes annually and cost the state government $817m. That works out as a net burden of $102 per head. Anti-immigrant agitators will seize on this figure, worries Mr Kasarda, a professor at the University of North Carolina's Kenan-Flagler Business School. But it is dwarfed by the positive impact of Latino spending in North Carolina, which he estimates at $9.19 billion in 2004. That translates into nearly 90,000 new jobs, he says.

The worry that America is importing a new Hispanic underclass, as some claim, is also probably unfounded. Granted, foreign-born Hispanics are less educated and earn less than the average American. But that is hardly surprising, given that so many were until recently Mexican peasants. What matters is whether they are socially mobile, and it seems that they are. Although, by some measures of income and education, the Hispanic average is not improving much, that average is dragged down by a steady influx of poor Mexicans. A better way of gauging progress is to look at inter-generational differences.

First-generation male Mexican immigrants earn only half as much as white men. But the second generation have overtaken black men and earn three-quarters as much as whites. They enjoy more benefits than the first generation, too: they are twice as likely to have employer-provided pensions and one-and-a-half times more likely to have health insurance. And the adult daughters of Mexican immigrants, having learned English, are much more likely to have jobs than their mothers were.

Some economists, notably George Borjas of Harvard, grumble that “about half of the differences in relative economic status across ethnic groups observed in one generation persist into the next.” Maybe so. But in absolute terms, Mexicans have grown much richer by coming to the United States. If they had not, they would go home. And their children are doing even better. Whereas only 40% of first-generation Mexican immigrants between the ages of 16 and 20 are in school or college, nearly two-thirds of the second generation are. Between the ages of 21 and 25 the leap is even more striking, from 7.3% to 24.4%.

For many first-generation immigrants, getting their children into an American university is the final proof that they have made it. Marco Roldan, for example, has been in America for 22 years but still has a Guatemalan accent and odd syntax. He started his career selling tortillas door to door. After many 75-hour weeks, he now owns a supermarket in Raleigh, where a mostly-immigrant clientele pays cash for Latin pop music, live tilapia and a wide variety of chillies. Mr Roldan is proud of his hard-earned wealth, but not as proud as he is of his daughter's MBA from Stanford.

Washing windows, watching screens

Immigrants' children are typically American citizens, having been born on American soil. More than 90% speak English fluently; by the third generation, 72% speak nothing else. Many help their less-fluent parents with form-filling, as other children help their elders navigate the internet. The parents, in turn, try to infuse their offspring with their work ethic and entrepreneurial spirit. (Latinos open new firms at a rate three times the national norm.)

Miguel Lopez, who arrived from Mexico when he was 17, says his children will have a double advantage over him. Not only are they native-born Americans, but they are “native-born” to the information age. Mr Lopez is not doing badly himself: he owns a small window-cleaning firm. He woos customers by giving them instant estimates, which he can do because he looks at satellite photos of their houses online. His firm grossed $150,000 last year. With only a high-school education, he says, there is no other country where he could live so well. But his children will go to college, he says, and do something better than washing windows.

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Maine politics

Keeping it clean

Jun 15th 2006 | PORTLAND
From The Economist print edition

The public buys its own campaigns, thank you very much

THIS primary season in Maine, the air is abuzz with midges—“no-see-'ums” as locals call them—and not much else. “Abysmal”, was one official's description of the 15% or so turnout for the primaries for the Senate and the governor's office on June 13th, a gorgeous day in a state with an energetic tradition of voting. If Mainers do not care which candidates represent them in November's general elections, it is a remarkable thing. For these citizens have chosen to foot the bill for most of their politicians' primary campaigns, under the state's Clean Elections Act.

Maine takes “Dirigo” for its motto, the Latin for “I lead”. It tends to go its own way in politics, experimenting to improve health care and education. Now it is the leader in campaign-finance reform.

The new law, passed by referendum ten years ago, requires that the state itself must pay for the campaign of each candidate who forswears traditional fundraising. To qualify for public funding, a candidate for governor must first gather 2,500 contributions of $5 each. Then the state doles out a generous war chest, as much as $1.2m this cycle, in exchange for the candidate's commitment not to raise or spend any other money. Old-fashioned candidates who wish to pay their own way to the polls are free to spend their money as they please. But if any privately funded candidate spends more than the public purse has given to his rivals, the state is obliged to try matching the higher amount.

This bold effort to curtail corruption is, of course, expensive. To guarantee their clean elections, Maine's 1.3m residents may spend as much as $4.8m to see four candidates run for governor later this year. An academic critic of the law hopes that “the spectacle of seeing people we've never heard of thrashing about on the airwaves” on the taxpayers' dime may put paid to the law. But most polls show Mainers to be happy with their strict system. Other states eager to reduce the influence of special-interest money in governance—Vermont, Arizona, Massachusetts, Connecticut—have taken it as a model, and a California initiative, the Clean Money and Fair Elections Act, looks likely to reach voters in time for a November referendum.

The issue cuts cleanly across partisan lines. Three Republicans competed in the primary to win a shot at facing the incumbent governor, John Baldacci, in November. Two of them accepted public funds, while Mr Baldacci, a Democrat, is raising his the traditional way.

Perversely, it would seem, Senator John McCain, a champion of campaign-finance reform on the national stage, came to Maine last month to raise funds for the one Republican who opted out of the clean-elections system. Republican voters had complained that the candidates were otherwise too similar. The candidates obliged them by making a competitive point of their fundraising. Mr McCain's man, David Emery, boasted that he accepted “supporters' money” rather than “tax money” for his campaign. One publicly funded rival, Peter Mills, retorted to a debate audience that Mr Emery “has taken many thousands of dollars from the tobacco industry, and I suggest to you that is an insult to the people of Maine.” The most conservative of the three, Chandler Woodcock, kept mum and won the nomination.

The man he will face, Mr Baldacci, refrains from saying much about the Clean Elections Act. But he notes in a folksy way that he was brought up in a restaurant family, where he was taught to serve the guests first. Maine has faced dire fiscal strains and painful cuts during his first term and suffers one of the highest tax burdens in the country. Mr Baldacci would rather not serve himself from the public trough, he suggests, until after he has seen the state's budget meet more urgent priorities.

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Virginia politics

Webb's way

Jun 15th 2006 | RICHMOND
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A Democratic candidate in sand-coloured combat boots

ON THE face of it, James Webb seems an unlikely Senate candidate. A writer, three times married, he proudly recounts the daring deeds of his Scots-Irish ancestors who fought for the South in the civil war. In his youth, as a Naval Academy boxer, he bloodied Oliver North's nose. Mr Webb is not much good with people, and has no patience for such campaign chores as fund-raising. He knows little about the issues, save one: the war in Iraq, which he passionately opposes.

Perhaps that is enough to fuel a campaign which, only a few months ago, seemed nothing more than a fantasy advanced by Democratic bloggers. For now this decorated Marine combat veteran, once Ronald Reagan's secretary of the navy, is the Democratic nominee for a Senate seat from Virginia.

What may have been a fairly predictable Senate race is now, at a minimum, a referendum on a war ardently supported by the Republican incumbent Mr Webb will face: George Allen. A cheerful conservative partisan whose only experience in uniform was that of a below-average college football quarterback, Mr Allen had hoped for an easy re-election campaign so that he could focus on his ambitions for the Republican presidential nomination, and all the trips to Iowa that requires.

Now he may have to stay at home. He not only needs to look after a state party badly divided by a marathon tax fight in the state assembly, but has to assuage Republican and Republican-leaning voters who are angry about petrol prices, economic uncertainty and the war. Eighty soldiers from Virginia have died in Iraq so far.

Mr Webb, who defeated Harris Miller, a former lobbyist, for the Senate nomination, has always let his passion for national security determine his party allegiance. Although a Democrat by background, gentle Jimmy Carter caused him to flee to the Republicans. Six years ago he endorsed Mr Allen over Charles Robb, the Democratic incumbent, complaining that the Clinton White House and its allies in Congress had done little to protect the United States from terrorism. But Mr Webb now finds George Bush at fault for gravely misjudging the terrorist threat, and has reverted to being a Democrat again.

His concern is also personal. His son, a Marine lance-corporal, is about to leave for Iraq. In a sign of solidarity with the young warrior—and a clever counterpoint to Mr Allen's Bush-style cowboy boots—Mr Webb wears the sand-coloured combat boots that are issued to American troops. He also travels the state in a camouflage SUV driven by a Marine buddy who lost an arm in Vietnam.

All this may conjure up an image of another straight-backed Democrat, clinking with combat decorations, who was supposed to have crossover appeal during a war-time election. And indeed John Kerry was among a crowd of senators who endorsed Mr Webb for the nomination, helping to bolster his still-somewhat-shaky Democratic credentials.

Democrats are hoping Mr Webb's campaign may be what Mr Kerry's was not: an exercise in skilled anticipation of Republican attacks on his military record. That may explain Mr Webb's campaign motto, inspired by the title of his book about his scrappy forebears, “Born Fighting”.

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The president's ratings

Up at last

Jun 15th 2006 | WASHINGTON, DC
From The Economist print edition

A sudden rush of better news, and not entirely fortuitous

THE White House enjoyed a rare spate of good news this week, triggered by the elimination of Abu Musab al-Zarqawi and the completion of a new Iraqi government. On June 13th, George Bush made a dramatic visit to Baghdad—a visit that included the bonus of white-knuckle flights in blacked-out helicopters and hundreds of troops cheering their commander-in-chief. This came hard upon news that Patrick Fitzgerald, the special prosecutor in the Valerie Plame affair, has decided not to press charges against Karl Rove, the president's chief political adviser. All in all, a big shot in the arm for morale.

AP

What was your name again?

Zarqawi's death reinforced the belief that American troops will eventually capture or kill Osama bin Laden. Mr Rove's escape removes the pall that has hung over the administration for months, distracting "the Architect" from his plans for the mid-term elections. In an interview with the *Washington Post* Grover Norquist, a conservative activist close to Mr Rove, compared him to a bull that has been poked. "Not only is he in fine fettle, not only is he not wounded, he's pricked enough to be angry."

The good news has also halted Mr Bush's fall in the opinion polls. His ratings have shifted from a low of 31% in May to 38% this week, according to *USA Today*/Gallup. Zarqawi's death has boosted confidence in a positive outcome in Iraq. A *USA Today*/Gallup poll taken over the weekend after the good news found that 48% believe that America will "probably" or "definitely" win the war there, up from 39% in April. Another Gallup poll, conducted at the same time, found that Mr Bush's approval ratings are improving on a broad front.

There is more to this than simple good luck. Since Josh Bolten took over as chief of staff, the White House has seen the appointment of a Wall Street giant, Hank Paulson, to run the Treasury, the arrival of a slick media man, Tony Snow, to run public relations, and advances in Iraq. Mr Bolten cannot take credit for all of this. But he has undoubtedly injected new dynamism into the team.

Second, the Democratic Party continues to flounder. The party's lacklustre congressional leadership is guilty of one of the crudest political errors—counting your chickens before they hatch. Nancy Pelosi

recently gave a series of interviews on what she will do when she becomes speaker, while John Murtha announced that he was running for the position of majority leader, an announcement he then withdrew. But there is also deep disagreement on the Iraq war. Congressional Republicans are currently tabling a resolution to reject a timetable for American troop withdrawal, mostly in order to expose the Democratic Party's divisions once again.

None of this proves that Mr Bush is out of the woods. The new Iraqi government is fragile. Two-thirds of Americans think that the country is on the wrong track. The smell of corruption hangs in the air. But nevertheless it does suggest that there may be life in the Bush administration yet.

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New Orleans

Beyond the razor-wire

Jun 15th 2006 | NEW ORLEANS
From The Economist print edition

Should the dwellings of the poorest be rebuilt at all?

THE St Bernard housing complex, the biggest in New Orleans, had been falling down for years. But Hurricane Katrina made things much worse, both there and at other large, government-owned housing projects in the city. The water that flooded the raised ground-floor apartments at St Bernard has long since subsided. But the 1,300-unit complex has remained empty, save for abandoned possessions. A chain-link fence topped with razor-wire keeps trespassers out, as well as displaced residents who would like to retrieve their things.

The Housing Authority of New Orleans (HANO) has begun to put people back in some of its properties. But it is still testing conditions at others. And on June 14th the federal Department of Housing and Urban Development (HUD), which directly controls the New Orleans authority, announced that St Bernard would not re-open. It will be razed to the ground.

More than nine months after Hurricane Katrina, New Orleans has become a vast social-science and urban-planning experiment. Before the storm, HANO had begun tearing down traditional housing projects, which had become hotbeds of violence, and replacing them with mixed-income developments. The quandary the agency faces now is how much to spend on restoring buildings that are meant, eventually, to be demolished.

A thornier question also arises. To what lengths should New Orleans go to bring its poorest residents back? Government-owned apartment buildings make up a larger part of the housing stock than in most cities. Before the hurricane, New Orleans was only the 35th-largest city in the United States; but it had the eighth-largest public housing authority. Size was no guarantee of competence. After decades of mismanagement, HUD took over in 2002.

The housing authority estimates that 60% of its tenants want to return. Many evacuees who fled to Houston and elsewhere after the hurricane say they are no longer welcome in their host cities. Displaced public housing tenants feel cut off from friends and relatives, and are angry that they cannot go back and retrieve their possessions. Now that New Orleans has a shortage of homes and labour, fair-housing advocates say there is no good reason to keep salvageable public housing closed. And they are wary of HANO's plans to build mixed-income dwellings. When the agency demolished the St Thomas project, which had 1,500 units, the River Garden development that replaced it had far fewer apartments for the poor.

The residents of St Bernard now say they will fight demolition. On a grassy patch near the fence outside the project, former residents have already put up a makeshift “survivors' village” to protest against their exile. Lynette Bickham, once a HANO repairwoman, lived in the complex for most of her life. She says it should be easy to make it habitable again. “Mould on brick walls? Clean them, bleach them down and paint them, and they're good to go. And the same for the floors.” Tell that to the housing authority.

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Baseball bats

The magic of maple

Jun 15th 2006 | LOUISVILLE, KENTUCKY
From The Economist print edition

A story especially for those not watching the football

AT THE Louisville Slugger factory in Kentucky, making a baseball bat looks almost easy. The countless cylinders of wood stacked up against the walls can be cut into sluggable shape in under a minute. The bats then get dunked in paint (recently they were pink for breast-cancer awareness) and are allowed to drip dry. Many are made to the specification of major league stars, who tend to order several dozen of their favourite model each year.

Reuters

Another homer from Bonds

This factory, which has been turning out bats for 122 years, is the big leagues' leading supplier and has long since become part of baseball lore. But recently it has had to adapt to a revolution in the bat business. One powerful driver of change, quite literally, has been Barry Bonds of the San Francisco Giants. Mr Bonds is no slouch as a slugger: on May 28th he passed Babe Ruth's 71-year-old record for career home runs, with 715. He now lags only Hank Aaron (755) on the all-time list.

Among Mr Bonds's secrets is a new sort of wood for his bat. When the slugger entered the major leagues 20 years ago, most players were using bats made of white ash from New England forests. Mr Bonds switched to maple, a heavier but harder wood that is less liable to splinter. Hundreds of hitters followed suit. The Louisville Slugger factory now makes more than half of its wooden bats from maple, up from virtually none five years ago. Other companies, such as Ontario-based Sam Bat which equips Mr Bonds, devote themselves entirely to the new wood.

Bats today weigh less than those of yore, since a lighter bat is easier to swing. Mr Bonds's bat weighs 32 ounces (almost a kilogram); that of the Babe, who bulked up on beer and hot dogs, was a whopping 42

ounces. In baseball's early days, hickory and oak were often used, but these are too heavy now. Even today, bat companies are constantly scouring the globe for new hardwood species that could be the “next maple”.

High schools and colleges, however, rarely use wood bats at all. They prefer metal. Although aluminium bats are expensive (up to $300, against $60 for a maple bat) they hardly ever break. They are also easier to get hits with, which makes amateurs feel good. Pro scouts would love to see college-level baseball switch over to wood, so they can see how the kids hit with the real stuff.

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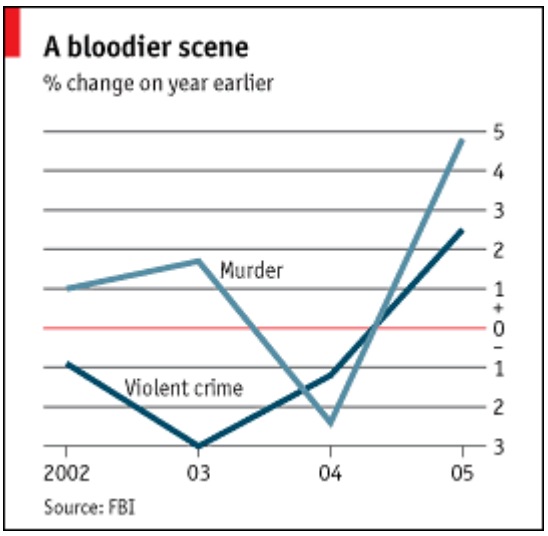
Crime

Bad news about bad guys

Jun 15th 2006 | WASHINGTON, DC
From The Economist print edition

Violent crime appears to have stopped falling

AMERICANS worry about crime. In a big country with hyperactive media, any sensational horror is quickly broadcast from coast to coast, making many people nervous. Last year, for example, after a teenager shot dead ten people in and around a Minnesota high school, pollsters asked a sample of Americans how likely it was that a similar massacre might occur in their own town. Nearly three-quarters said it was “very” or “somewhat” likely.



The FBI's announcement this week that violent crime rose by 2.5% between 2004 and 2005 will soothe no nerves. Nor will the news that murders jumped by 5%—the biggest spike in 15 years. The new numbers should be treated with caution; they do not yet take account of population growth, which is about 1% a year. But still, some experts worry that America's long run of success in reducing crime may be over.

Why did it fall? Some credit “zero-tolerance” policing. Some think long jail terms keep the worst offenders out of circulation. Others look at demographic factors, such as the legalisation of abortion in 1973, which some argue, controversially, prevented many potential criminals from being born. Now their number is rising again.

The sharpest increases in murders last year occurred in the Midwest, in cities such as Omaha and Milwaukee. Granted, a 55% increase in Omaha is only 11 more murders. But the numbers highlight a trend for the big gangs of New York and Los Angeles to spread into heartland towns. “A small group of youths are carrying guns, wearing colours and killing each other over trivial disputes,” says George Kelling of the School of Criminal Justice at Rutgers University. Mostly, it is not about turf, but about “dissing”, he says.

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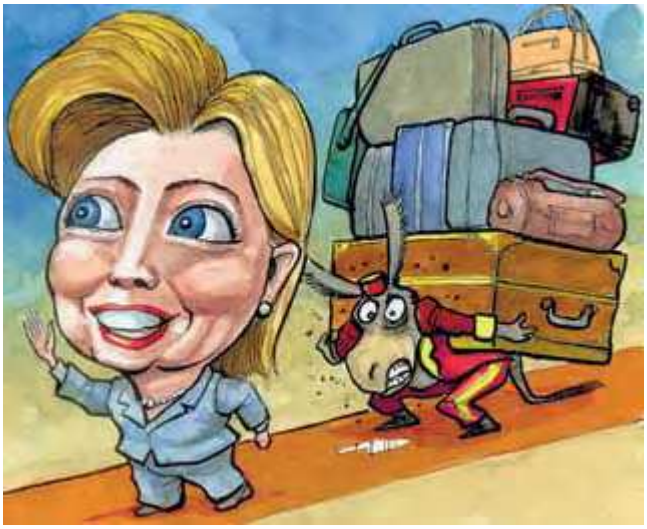
Lexington

Doubting Hillary

Jun 15th 2006
From The Economist print edition



Democrats have growing worries about the front-runner for the presidential nomination. But can they stop her?

LAST autumn, “Commander-in-Chief”, a prime-time drama about America's first female president, opened to 16m viewers and a media love-fest. Surely now that Hollywood had anointed the first female president, in the lissom form of Geena Davis, the real thing could not be far behind? Alas, last month ABC unceremoniously pulled the plug on the series.

A growing number of Democrats wish that their party would do the same with Hillary Clinton's (still undeclared) bid for the presidency. Mrs Clinton is the front-runner for the Democratic nomination by a large margin—with $20m in her war chest, 36% of Democrats favouring her candidacy compared with just 16% for Al Gore, her nearest rival, a well-oiled national machine inherited from her husband, and a chance to pivot neatly from her Senate re-election campaign in November to a national race.

Yet hardly a day passes without signs of doubt in her party. In a recent poll of likely voters in the 2008 Iowa caucuses, which kick off the presidential season, Mrs Clinton came second to John Edwards, John Kerry's running mate. A straw poll among the so-called Kossacks who frequent the Daily Kos, a liberal website, gave her 2% of the vote. The anti-war left might even field a candidate against her in the New York Senate primary.

Some of these doubts were on display this week at a Washington, DC, conference organised by the Campaign for America's Future. The 2,000 or so activists were the sort of people who happily stand up and cheer whenever you mention “taking back our country” or “the misleaders in the White House”. A roster of leading Democrats, including Harry Reid, Nancy Pelosi and John Kerry, did just that. But the response to Mrs Clinton, decked out in an orange trouser-suit, was much more nuanced. The audience delivered dutiful applause whenever she urged more money for education or health care. But a few booed even before she took the stage. And a vocal minority erupted in protest when she talked about “keeping faith with the troops”. She left the room to cries of “Bring them home, Hillary.”

Mrs Clinton's biggest problem goes deeper than the angry left. One poll (by Gallup) shows that 51% of registered voters would not consider voting for her. Another poll (ABC News/*Washington Post*) showed that 42% of Americans have either a “strongly unfavourable” or “unfavourable” view. Many Democrats

are drawing the obvious conclusions from these extraordinary negative ratings: in a survey of Democratic voters in New York state, 57% said that it was either “not very likely” or “not likely at all” that she could win a presidential election.

Mrs Clinton is not only an enormously polarising figure. She also has more than her fair share of skeletons in the cupboard. Remember Marc and Denise Rich? Remember Giftgate (when the Clintons left the White House with more than $100,000 in loot)? Remember cattle futures? Many Democrats worry that a Clinton candidacy will galvanise the Republican right at a time when it is depressed and divided; that it will make it harder to attract Republican moderates who are increasingly alienated from their party; and that it will allow the Republicans to change the subject from the Bush scandals to the Clinton scandals.

These doubts are reinforced by worries about her political persona. Look at her decision to co-sponsor an anti-flag-burning amendment, or her discovery, despite her continued support for partial-birth abortion, that abortion is a “tragic choice”, or her fulminations against the laziness of the young. All these seem to be crude attempts to mollify “values voters”. It is true that Bill Clinton did much the same thing. But he managed to dress his move to the centre in the language of “New Democracy”. Mrs Clinton clearly hoped that she could move to the centre without alienating the Democratic base; the danger is that she is annoying the base without persuading the centre that she is electable.

The Hillary trough is coinciding with a Gore boom. Mr Gore is currently the darling of the Democratic left—a prophet, hero and elder statesman rolled into one. Mr Gore was one of the first senior Democrats to denounce the Iraq war, and a relentless critic of King George's centralisation of power. His decision to build his environmentalism into a global-warming crusade was a political masterstroke, humanising him and providing him with a platform that most of the Democratic base likes.

Towards the glass ceiling

But doubting Hillary is one thing. Derailing her is quite another. The woman in the trouser-suit still has enough in-built advantages to survive a storm of doubts—from star power to a national political network to a fearsome reputation for taking revenge on people who cross her. The studio-dwelling Kossacks may dislike her, but she has solid support from more established interest groups, from minorities to the trade unions.

Mrs Clinton's supporters point out that the “skeleton in the cupboard” argument works both ways; most Americans remember the Clinton years as an age of peace and prosperity. They also point out that she stands up well to any of her potential rivals. Mr Edwards is stuck in a “two Americas” rut. Mark Warner, Virginia's ex-governor, comes across as a lightweight, they say, vague on details and bereft of foreign policy experience. The new Al Gore contains the old Al Gore, made of best hardboard and just waiting to come out. Hillary, by contrast, is disciplined, focused and relentless, with a mastery of domestic policy and years on the Senate Armed Services Committee.

All this guarantees a wild ride for the Democrats in the coming political season. A large number of candidates will stay in the race, waiting for Mrs Clinton to trip on some mouldering bone or other. And even if she wins the nomination, the Democrats will remain nervous, thrilled by the possibility that their party might break America's ultimate glass ceiling, but terrified that Mrs Clinton is just too polarising to do it.

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Infrastructure in Latin America

Slow! Government obstacles ahead

Jun 15th 2006 | BELO HORIZONTE, MEXICO CITY AND SANTIAGO
From The Economist print edition

The public sector in Latin America is not spending enough on transport, electricity and water, but nor is it allowing private investors to help out

Reuters

IT IS impossible to see such a thing and disbelieve in progress. Where there was air, there is rock. Where there was rock, there is air. Where there was no lake, there will be a lake. El Cajón, a dam 188 metres (617 feet) tall in Nayarit, in western Mexico, is to generate 750MW of electricity starting in 2007.

El Cajón is Latin America's biggest construction project. It is also a rarity. In Mexico, public spending on infrastructure—electricity generation, roads, railways, water plants and the like—was a third lower in 2004 than a decade earlier, according to a report by Merrill Lynch, an investment bank. The World Bank describes two-fifths of the country's motorways as “pre-modern”. Nevertheless, the government has found the money to spend 0.7% of GDP on subsidising the electricity that is consumed—which does nothing for the poorest, who live in the dark in rural areas.

So it is across Latin America. Although the region's economies are growing faster, thanks to an export boom, they are hobbled by poor roads and railways, clogged ports and a precarious electricity supply. In the 1990s governments slashed public investment to balance their budgets. They invited private investors to make up the shortfall. Between 1990 and 2003, Latin America accounted for half of total private-sector participation in infrastructure in developing countries. Private investment has expanded telecoms networks. But the flow of private money for electricity, water and transport has dried up in many countries, partly because citizens or politicians turned against privatisation.

In recent years, total spending in the region on infrastructure has averaged less than 2% of GDP. It is not enough. According to the World Bank, 58m Latin Americans lack access to potable water and 137m lack sewerage. In Brazil and Peru, less than a quarter of the main highways are classified as good. In surveys by the bank, 55% of businessmen consulted in Latin America cite infrastructure as a serious problem compared with just 18% in East Asia. The bank says the region will have to double or triple its current spending to bring its infrastructure up to the level of that in East Asia's fast-growing economies.

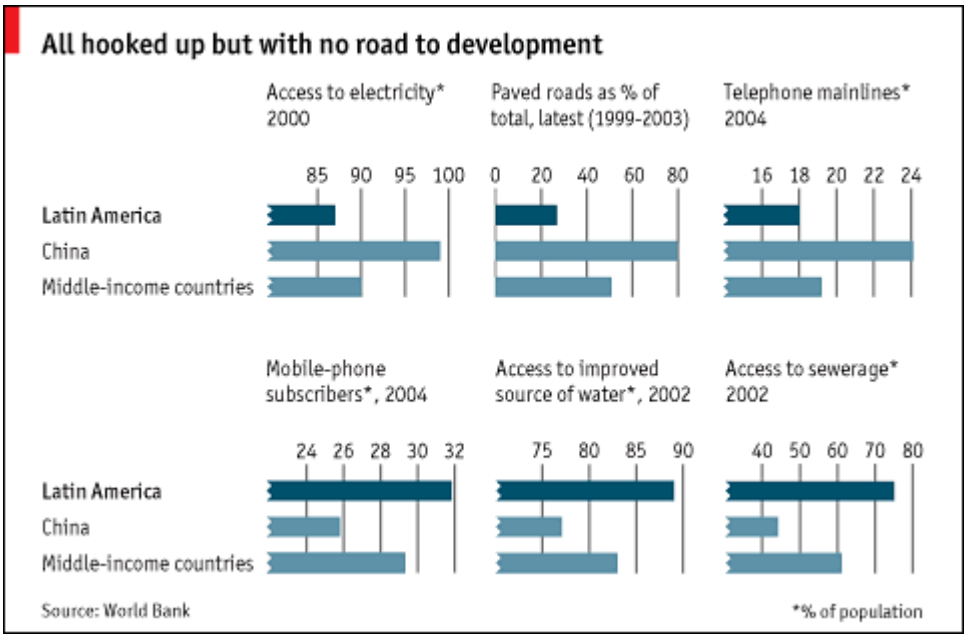
The exception, as so often, is Chile. Its military dictatorship began to privatise infrastructure in 1985,

starting with telecoms and electricity. Democratic governments have since gone further. Now the roads that whisk the traveller into Santiago, the capital, from the airport are privately run, as are most other motorways and the airport itself. Nearly all Chile's water is supplied by private companies. In Santiago treatment of sewage has increased from 3% in 1999 to 70% today, says Alfredo Noman, chairman of Aguas Andinas, the capital's Spanish-controlled water company. Only the most remote households in Chile lack running water or electricity.

Speeding along in Chile

Chile has been able to mobilise so much private money because its governments have established legal and regulatory procedures that investors trust. “In case of a dispute we have to go to arbitration, which we've used and it works,” says Mr Noman. It helps, too, that Chile has deep capital markets and big institutional investors, in the form of private pension funds. Long-term “infrastructure bonds”, denominated in inflation-adjusted pesos, have financed much of the $8 billion investment in roads, airports and the like.

Getting paid, another Latin American headache, is relatively easy in Chile. Autopista Central, a Santiago highway operated by ACS, a Spanish company, bills drivers each month instead of collecting tolls. That sounds risky, yet bad debt should be less than 3% of the total, says Antonio Estrada, Autopista Central's manager. Chile is planning to issue contracts for private investors to build and maintain public hospitals.



Success has not made privatisation popular. Chileans grumble that they see only new cars on the new roads, because drivers of jalopies cannot afford them. (The same is true of Mexico's privately built toll roads.) Running water is convenient, but backyard wells were free. In a 2005 survey by Latinobarómetro, a polling organisation, two-thirds of Chilean respondents were dissatisfied with privatisation—more than in Brazil and Mexico. Yet Chile has shielded investors from popular ire, unlike most of its neighbours. That is why ACS, for one, is not tempted to invest anywhere else in the region. “Political and economic stability is not good enough in other countries to make an investment for 30 or 25 years,” says Mr Estrada.

Of the larger countries in Latin America, only Colombia has managed to maintain public investment while also attracting private funds. Elsewhere, the picture is much more problematic. In a few countries, private capital faces outright hostility. Bolivia nationalised its oil and gas last month, and earlier chased multinationals out of the water industry. Argentina's government has re-nationalised the Buenos Aires water company, and has fought with other private companies over utility tariffs. It now plans to levy a charge on energy consumers to raise revenue for a newly created state energy firm.

Paralysis in Brazil

In Brazil, Latin America's biggest economy, initial enthusiasm for private investment in infrastructure has cooled. In the 1990s, the government privatised telecoms, railways and electricity distribution, and turned 5,000km (3,100 miles) of federal highways over to private operators. Luiz Inácio Lula da Silva, Brazil's president since 2003, promised a break with the “neo-liberal” policies of his predecessor. Under his government, neither private nor public investment in transport, electricity and water has taken off.

Infrastructure will be “a point of strangulation”, holding the rate of economic growth to less than 4%, predicts Adriano Pires of the Centro Brasileiro de Infra Estrutura, a consultancy. The federal investment budget is just 0.5% of GDP. Add in lower levels of government and state companies, and public spending on infrastructure totals about 2%—probably not enough to maintain the stock of infrastructure.

Since Brazil has little scope for raising taxes and debt and cannot easily re-allocate spending, it will have to rely on the private sector over the next few years, believes Paulo Correa, co-author of a forthcoming World Bank report on Brazilian infrastructure. Yet the climate for private investment is forbidding. Regulators and the courts cannot be counted on to uphold contracts. In a recent survey of 21 regulatory agencies, 12 reported attempts by government to interfere in their decisions.

The rules themselves are in flux. Take electricity. Lula scrapped a system which used price signals to induce investment in generation. But the replacement—centralised auctions based on demand forecasts by distribution companies—has failed to attract investors, partly because of a government price cap. Investment in water and sewerage is stymied by a fight between lower levels of government over which should control it. In Brazil 36% of concession contracts have been renegotiated, usually at the instigation of the government—above the regional average of 30%. All but the most profitable investments have been deterred by the high—though now falling—cost of capital.

At least there is some new thinking, if not yet enough new roads. Policy on infrastructure in Latin America is at an “inflection point”, reckons Antonio Vives of the Inter-American Development Bank (IDB). Novel blends of public and private ownership and management are appearing.

After downplaying lending for infrastructure in the region for years, both the IDB and the World Bank are eager to dive back in. A “partial risk guarantee” from the World Bank protects investors in Peru's roads, airports and ports from breaches of contract. The IDB is contemplating loans to slow the rate of increase in utility tariffs, assuaging one main cause of resentment.

Brazil, after much delay, is launching a scheme under which private companies can build and operate roads, sewerage systems and even jails in exchange for a stream of revenue guaranteed by the government. Local firms are less queasy than international investors about risk. “Can we wait to reach the level of Chile? We need to accept a little the conditions there are,” said Marcelo Odebrecht, boss of a construction firm that bears his surname.

Mr Odebrecht's appetite for risk is commendable, but governments' reliance on it is not. Investment in infrastructure pays big dividends for the poor and reduces inequality. Governments that cannot finance infrastructure while also scaring away those who can are doing their voters no favours.

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Cuba

Send in the social workers

Jun 15th 2006 | HAVANA
From The Economist print edition

Fidel Castro declares war on corruption

WATCHING political change in Cuba is usually like looking at a glacier: you know in theory that it must be moving but you never see anything happen. Yet the past couple of months have brought a flurry of changes at the top. In five out of 14 provinces, the top Communist Party official has been replaced. So have the ministers of light industry, higher education and audit and control. In April, Juan Carlos Robinson, one of the youngest members of the 21-strong politburo, was abruptly sacked. The official media announced that he had failed to overcome “errors” such as “abuse of authority” and “ostentation”.

As the alleged sins of the ostentatious Mr Robinson suggest, the motive for many of the changes is Fidel Castro's campaign to root out corruption. In November, in a speech delivered from the mahogany-panelled splendour of Havana University, the president painted a picture of widespread graft throughout the state-controlled economy. This, he said, was endangering the communist system: “We can destroy ourselves, and it would be our fault.”

The choice of a university as the venue for this speech was deliberate. In a quest to recover his revolution's ideological purity, Mr Castro, who will be 80 in August, is turning to the young. At the forefront of the anti-corruption campaign are 28,000 students of social work. Dressed in black or red T-shirts, for several months they manned petrol stations across the country, noting every litre sold. This exercise revealed that, previously, about half of all fuel sold was not accounted for.

Now students of economics are being sent on “missions” to audit state companies, where they have uncovered slack accounting and rampant pilfering. There are even rumours that money is leaking from the party's own budget. Soldiers are also being pressed into anti-graft duty. The armed forces are now managing Havana's port, where entire containers went missing when civilians were in sole charge.

Corruption is not new in Mr Castro's Cuba. Its people have long talked euphemistically of “resolving” their needs by finding unofficial ways round shortages and rules. Several solicitors have been prosecuted recently for selling houses—illegal in the workers' paradise, where people are allowed only to swap, not sell, their homes. Many people find irregular ways to top up wages that average around $15 a month (not counting subsidised food and services).

Some Cubans doubt whether the latest crackdown will work. “It's crazy,” said a motorist waiting to fill up at a Havana petrol station. “We are bringing kids in from the provinces, and giving them a crash course in inequality and theft.”

Why crack down now? One reason is that the economy, helped by subsidies from Hugo Chávez, Venezuela's president, is doing better. This has allowed Mr Castro to re-impose central control, rolling back the limited market reforms he accepted in the 1990s. What may count for more is that Mr Castro is increasingly preoccupied by his legacy. He has often argued that the Soviet Union was brought down by corruption at home rather than external pressure. What he now appears to want above all else is to avoid his revolution suffering a similar fate when he goes. Then the glacier may really start to move.

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Argentina

Taking on the penguins

Jun 15th 2006 | BUENOS AIRES
From The Economist print edition

Roberto Lavagna edges towards a presidential candidacy

Reuters

When Kirchner (left) trusted Lavagna

OF THE larger countries in Latin America, Argentina is the only one without a presidential election this year. Its presidential poll is due in 2007, probably in October. But already electioneering is in the air—and suddenly it looks as if Néstor Kirchner, the incumbent president, may face a strong challenger.

Mr Kirchner has been fortunate enough to preside over a robust recovery from financial collapse in 2001-02. He is hugely popular. His advisers insisted that a mass rally he organised, attracting several hundred thousand supporters to Buenos Aires's Plaza de Mayo for the country's national day last month, had nothing to do with his bid for a second term. But soaring above the Casa Rosada, the presidential palace, was a giant inflatable penguin—a reference to the president's Patagonian roots—emblazoned “Kirchner 2007”.

It had been assumed that Mr Kirchner would coast to victory next year. Now a potentially powerful opponent has emerged: his former economy minister, Roberto Lavagna. As the one other politician who can claim credit for four consecutive years of growth averaging over 8% a year, Mr Lavagna represents the only credible threat to the Kirchner juggernaut.

Both men say they enjoyed a pleasant and productive working relationship. But Mr Lavagna was never the president's man. He was appointed by Eduardo Duhalde, the previous occupant of the Casa Rosada, who helped Mr Kirchner to victory in 2003. It was Mr Lavagna who put in place many of the policies that halted the financial collapse.

No sooner had Mr Kirchner won a clear victory over Mr Duhalde's supporters in a congressional election last October than he sacked the independent economy minister, replacing him with a loyalist. He also tacked to the left. Faced with a 12% inflation rate, he forced “voluntary” price freezes on retailers. When producers of beef, a politically sensitive product, failed to sign up for a deal, he banned meat exports for six months. He also re-nationalised the Buenos Aires water company.

Mr Lavagna says he is troubled by this trend to “more state intervention...with less of a market economy”, as well as Mr Kirchner's recent flirtation with Venezuela's populist president, Hugo Chávez. As a result, he rejected what he calls “high-level informal overtures” from the government to offer himself as its candidate for mayor of Buenos Aires. He has begun to speak out, accusing the government of “closing in on itself and its inner circle” and promoting “crony capitalism” from which its supporters would profit.

Mr Lavagna says he will not decide until next year whether or not to stand against Mr Kirchner. But he has held meetings with several opposition politicians. He can expect to get support from Mr Duhalde and Raúl Alfonsín, another former president.

Mr Kirchner evidently sees his former minister as a threat. Officials have denounced Mr Lavagna as a right-winger. “He's an orthodox neo-liberal conservative, from the businessmen's gang that... left us in

the worst social catastrophe of our history," says Luis D'Elía, the deputy secretary for social housing. As Mr Lavagna notes, such vituperation sits ill with Mr Kirchner's call in the Plaza de Mayo for a "more pluralistic country". And "right-winger" is a description Argentina's bondholders, who had to accept a huge debt write-off, and the IMF might dispute.

If Mr Lavagna does decide to stand, he will face other obstacles besides Mr Kirchner's popularity. He cannot hope to compete with the president's war chest. The government's coffers are overflowing, thanks to taxes on Argentina's booming exports. Ahead of last year's congressional election, Mr Kirchner lavished public-works projects on the province of Buenos Aires to encourage Mr Duhalde's supporters to defect. He will probably do the same next year. By vanquishing Mr Duhalde, the president won unquestioned control over the hegemonic Peronist party—as the rally on May 25th was intended to show. Mr Lavagna commands no party machine.

But Mr Lavagna does not seem daunted, and the president's attempt to deter him appears to have backfired. "There is something lacking in the political sphere, and perhaps I could be part of an alternative," Mr Lavagna says. Mr Kirchner may yet come to regret having fired his awkwardly independent minister.

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Inequality in Japan

The rising sun leaves some Japanese in the shade

Jun 15th 2006 | TOKYO
From The Economist print edition

An emotional debate about those untouched by the economic recovery

Get article background

IN A country that very nearly defines itself by its egalitarianism, an anguished debate in parliament, in newspaper columns and on television shows has gathered pace this year about Japan's widening gap between the haves and have-nots. Arch-conservatives and left-wingers alike blame the income gap not just on globalisation clobbering the unskilled, but on the structural reforms and deregulation championed by the prime minister, Junichiro Koizumi, and his Liberal Democratic Party (LDP). Over the past few years, the critics charge, companies that once protected their workers have been able more easily to sack them, or redesignate them as “non-regular” staff, who come cheaper. Young adults, even graduates, have suffered in particular, many unable to get full-time work or any work at all.

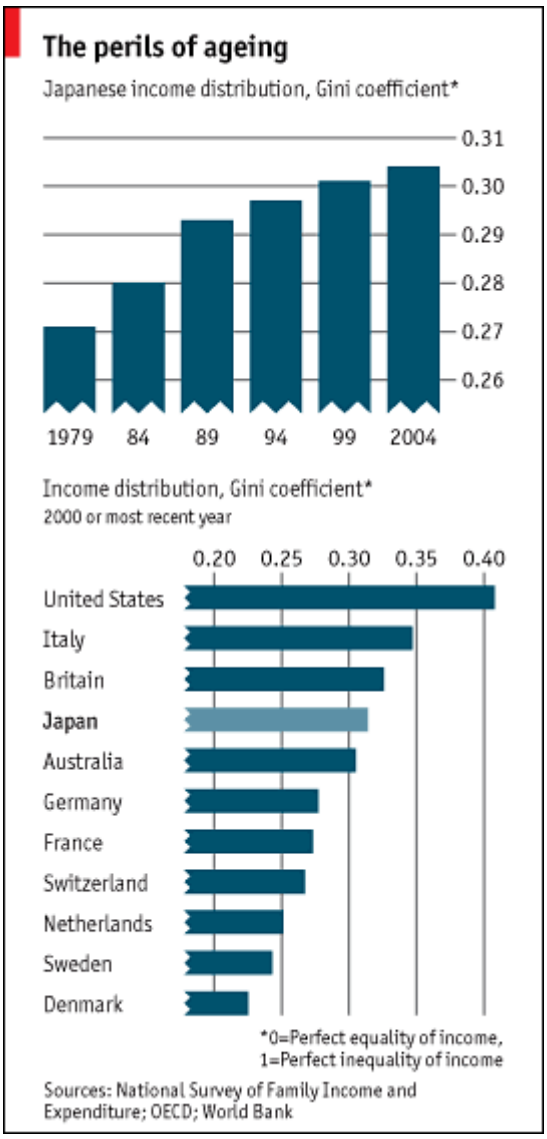
And as the poor have got poorer, so the rich have multiplied. This year, two entrepreneurs now under arrest for market manipulation and insider dealing—Takafumi Horie, the brash young former boss of livedoor, an acquisitive internet company, and Yoshiaki Murakami, an ex-bureaucrat who turned shareholder activist and corporate raider—have become emblematic of Japan's growing disparities. Commentators seem less offended by their alleged flouting of securities laws than by their drive for profits.

Motonari Otsuru, the senior Tokyo prosecutor investigating them, is explicit. In a speech before the arrests he said: “We cannot let this become a society where people who sweat from their labour, or who want to work but can't because of restructuring, can be taken advantage of.” The admission on June 13th by the central-bank governor, Toshihiko Fukui, that he was an early investor in the Murakami Fund (see article) appears to be further proof of the conspiracy of the rich against the poor.

With the income gap a big topic in the race to succeed Mr Koizumi as prime minister this September, it is worth taking a closer look. Statistical problems always guarantee that the income gap, in any country, is contested ground. Even so, no matter which data are used, the trend looks the same: income inequality in Japan has risen since the early 1980s. The first chart below, using one trusted series, shows the Gini coefficient, a measure of income inequality where 0 represents equal pay for all households while 1 would represent perfect inequality—a single household taking all income. Work by Toshiaki Tachibanaki, an

economics professor at Kyoto University, puts Japan behind only the United States, Britain and Italy in income inequality among the big rich economies. It once boasted Scandinavian levels of equality.

Yet a closer look at the reasons behind the rise in inequality reassures somewhat. Fumio Ohtake, at Osaka University, notes that income distribution by age of household head has remained constant. In other words, the rise in the Gini coefficient can mostly be explained as a statistical outcome of Japan's rapidly ageing population. Older people tend to have the widest income disparity, since while some people retire to live on modest pensions, more senior managers get hefty pay rises in the last years of their working life, with pensions afterwards to match. An ageing population therefore scores higher on overall measures of inequality.



This effect counts for much more than any income gap among the young. All the same, that gap has grown among those under 30, according to a 2004 survey. This is probably due to an increase in the number of unemployed and those in part-time work. Between 1990 and 2005, the number of “non-regular” workers—ie, those on lower pay with neither full-time contracts nor benefits—rose from less than one-fifth to nearly one-third of the workforce, hitting the young (and working women) disproportionately.

Labour flexibility did much to help Japanese companies escape from piles of debt over the past decade, and partly as a consequence they are now making record profits. They are, indeed, busy hiring workers again, and more full-time ones than part-time. Furthermore, the recovery is spreading to the regions: in April the number of jobless fell by 260,000 from a year earlier, the fifth monthly fall in a row. Graduating students are finding work more easily than in previous years. Recruit, an employment agency, said in a recent survey that in the latest recruiting season, over 60% of students turned down their first job offer. Among the young, higher employment should start to reduce inequality.

The inequality debate will continue, however. Even though Mr Koizumi's most conspicuous reform—privatisation of the postal savings bank—has yet to lead to a single sacking, Japanese often equate deregulation with inequality. Take the taxi industry, for example, which has been opened up. Critics say there has been a fall in pay among drivers since deregulation, yet Mr Ohtake points out that the number of drivers has leapt, thereby reducing inequality. The rise in “non-regular” workers in Japan may in fact have narrowed the income gap, because the alternative was probably unemployment. But people do not see it that way.

Even so, hard choices lie ahead. The growing inequality among the old will be passed on when their children inherit their wealth. If Japan really does care about equality, then a debate about redistribution is on the cards.

More pressing is what to do about the unskilled young who will struggle to find full-time work despite the recovery. Their plight is magnified in Japan by an employment system that still emphasises recruitment directly after school or college: by 30, a part-time worker will find it increasingly hard ever to find a full-time job. Better policy is needed, says Mr Tachibanaki, if a Japanese underclass of the underprivileged, however tiny in comparison to America or Britain, is not to emerge.

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Taiwan

Shui-bian agonistes

Jun 15th 2006 | BEIJING
From The Economist print edition

But the president should survive

AFP

Chen's not worrying

CHEN SHUI-BIAN'S political fortunes have been at a low ebb for months. On June 13th, they took a turn for the worse as Taiwan's legislature started proceedings to recall him (ie, fire him as president of the country), amid allegations of corruption against members of his family and senior officials. He is most unlikely to lose his job, but for his remaining two years in office the president's authority could be seriously diminished.

China is watching warily. Normally eager to highlight Mr Chen's difficulties, official newspapers have said little about the attempts by the opposition in Taiwan to unseat him. Taiwan's raucous but democratic handling of corruption scandals is not an example that Chinese leaders are anxious to promote. Liu Zhihua, a deputy mayor of Beijing who was in charge of Olympics-related construction projects, was detained last week and dismissed for “corruption and degeneracy”. The official media have said virtually nothing about the charges.

No specific charges of wrongdoing have been laid against Mr Chen himself. But last month his son-in-law, Chao Chien-ming, was detained on suspicion of insider-trading. The president's wife, Wu Shu-chen, has been accused by the opposition of accepting gift certificates from a department store in return for help with its business. She has denied this. A former top official in the president's office, Chen Che-nan (no relation), was detained in April for allegedly accepting bribes. Another close aide, Ma Yung-cheng, resigned on June 1st. He too has been accused of corruption by opposition politicians.

Mr Chen tried to deflect criticism by announcing late last month that he would delegate more power to the prime minister, Su Tseng-chang, an ally and fellow member of the Democratic Progressive Party. But the president's job does not appear to be in jeopardy. Although the legislature has agreed, by 113 votes to 96, to launch recall proceedings, it is unlikely to build the consensus necessary to achieve this. Two-thirds of legislators need to approve a recall, which would then have to be endorsed by half of voters in a referendum with at least a 50% turnout. The opposition has only a slim majority in parliament. The vote is due on June 27th.

Officials in Beijing tend to endure no such ordeals. Right up until his detention by party investigators on June 9th, Liu Zhihua had been portrayed by official media as a staunch supporter of anti-corruption

efforts. He is the most senior official in the capital to be accused of corruption since the arrest of a former city party chief, Chen Xitong, in the mid-1990s. Officials insist Mr Liu's case has nothing to do with Olympics projects. But as a local paper in far-off Anhui province bravely lamented, the more senior an accused official is, the less is revealed about his corruption.

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China

Is anyone listening?

Jun 15th 2006 | BEIJING
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Chinese propaganda just isn't what it used to be

CHINA'S Communist leaders still fight their battles the old way. A wordy article by a pseudonymous author on the second page of the party's mouthpiece, the *People's Daily*, has just been used to deliver a message of defiance in the face of mounting public criticism of the country's economic reforms. The party's problem these days, though, is getting anyone to pay attention.

The article in the June 5th edition, warning that “reform and opening up” was “the only road”, was dutifully reprinted by newspapers around the country. Party committees have, as is also traditional, been holding meetings to study it. In Shanghai this week, President Hu Jintao has repeated its call for “unwavering” commitment to reform. All this fuss suggests that the leadership is feeling under pressure. In the past couple of years, some university and think-tank academics have become increasingly vocal in their criticism of the negative consequences of economic reform, such as a widening gap between rich and poor, an increasingly dysfunctional health-care system and asset stripping by managers of state-owned firms.

The appearance of the article, and a similar one early this month in a fortnightly party journal, suggests that strong pro-reform statements by Mr Hu and the prime minister, Wen Jiabao, in March have failed to quell the debate. So now the party's powerful Propaganda Department is lending its weight to the reformist camp. The pseudonym of the *People's Daily* columnist, Zhong Xuanli, is one the department has used before to signal its authorship (the name sounds in Chinese like an abbreviation of the Propaganda Department Theoretical Bureau).

The Propaganda Department, or Publicity Department as it likes to call itself in English, shuns foreign journalists. It is not listed in public telephone directories. Yet it wields great power over the country's media, culture and entertainment industries, deciding what can and cannot be reported, displayed, published, aired or performed.

But it is not as fear-instilling as it used to be. Last month Chinese internet portals published a letter criticising a senior government adviser and one of the Propaganda Department's former deputy chiefs, Liu Zhongde. Mr Liu had said that a hugely popular television talent show, the “Super Voice Girl” contest, was “sullying” art. One Beijing-based portal, Sina.com, even put up a web page allowing users to vote on what they thought of Mr Liu's remarks. Censors must also be unhappy that numerous Chinese weblogs reproduced a letter jointly written in February by a former Propaganda Department chief, Zhu Houze, and several other liberals, saying the department's controls on the media violated the constitution.

Jiao Guobiao, who last year was dismissed from his post as a journalism lecturer at Peking University after issuing a lengthy diatribe against the Propaganda Department (comparing it to the Roman Catholic church in medieval Europe), sees a glimmer of hope that things might be changing. He has not (yet) been arrested. The department has become like a “blunt knife”, says Mr Jiao. “In the past it could slice meat apart in a stroke, but now it's not so fast.”

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Thailand

Long to reign over them

Jun 15th 2006 | BANGKOK
From The Economist print edition

The remarkable but little-discussed story of the world's most durable monarch

IN 1946, when King Bhumibol Adulyadej was crowned, it would have been easy to imagine Thailand's monarchy going the same way as some others in Asia: reduced to a mere symbol, as Japan's was after the war; or perhaps even replaced by a republic, as Laos's was in 1975 and Nepal's may imminently be. A military-backed revolution in 1932 had already ended the absolute rule enjoyed by most of Bhumibol's ancestors in the Chakri dynasty. Re-establishing the crown's authority and popularity was a daunting task for the American-born teenager, who had spent most of his childhood in exile.

EPA

Something for the king to smile about

However, he succeeded. As Thailand has staggered through numerous coups and crises over the past 60 years, its king, now the world's longest-ruling monarch, seems only to have grown in stature and, above all, popularity. The huge crowds of joyous Thais, wearing royal yellow shirts, who thronged Bangkok's streets during the diamond jubilee of June 9th-13th, were testimony to this. They made the recent street protests by both supporters and opponents of the prime minister, Thaksin Shinawatra, look rather piffling.

The culmination of the celebrations, attended by royalty from 25 other countries, was a procession of gilded royal barges down the Chao Phraya river on the evening of June 12th. Among the yellow-shirted hordes on the riverbank was Chamroon Muennarong, a local teacher, enthusiastically snapping away with his camera. Asked what made the king so beloved, Mr Chamroon summed it up thus: “He is just very, very good.”

To most Thais, their monarch personifies the ancient tradition of the *dhammaraja*, the righteous king who rules according to Buddhist teachings, says Paul Handley, the author of a forthcoming biography of Bhumibol. He has accepted his duty wholeheartedly since unexpectedly becoming king, on the mysterious death by shooting of his brother, King Ananda. He has spent much of his reign visiting remote villages to hear his people's concerns, and has devised and overseen an array of projects to help poor rural Thais.

Besides this, the king has played a decisive role in ending political conflict, most notably in 1992, after Suchinda Kraprayoon, leader of a military coup, ordered troops to fire on demonstrators, killing scores of them. Television pictures showed Suchinda and the protest leader, Chamlong Srimuang, literally crawling

in to see the king, who firmly told them of their duty to stop the violence.

Thailand's present crisis pits Mr Thaksin against a protest movement led, once again, by Mr Chamlong. The king intervened in April, urging the country's judges to do something to sort out the “mess”. They annulled the snap election Mr Thaksin had called to shore up his support. But the conflict remains unresolved. Mr Thaksin stepped aside after an audience with the king, but he has since returned to office. Mr Thaksin's opponents will press again for his permanent removal, over allegations of corruption and abuse of power, now that the royal celebrations are over.

In his speech to the judges, the king pointed out that he is a constitutional monarch and cannot do whatever he wishes. His prestige and popularity make him far more than a figurehead. How much more, though, is unclear. Partly this is because the king always limits his overt interventions to extreme situations. Palace involvement in public affairs is usually conducted by courtiers, especially Prem Tinsulanonda, the president of the Privy Council. More importantly, the extent of royal influence is hard to discern because all discussion is constrained by a strict *lèse-majesté* law, enforced with long jail sentences; and by the strong public reaction that greets the merest hint of disrespect towards the crown.

This means that Mr Handley's book is unlikely to be allowed into Thailand. Whereas most books and articles on Thailand's recent history skirt the monarchy's role or coat it in honeyed praise, Mr Handley's is expected to lift the thick veil of reverence and poke into some dark corners. The king said recently he was prepared to accept criticism. His courtiers, though, and most of his subjects will want to hear nothing but praise for their sovereign.

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Malaysia

Moaning Mahathir

Jun 15th 2006 | BANGKOK
From The Economist print edition

A sad case of post-prime-ministerial syndrome

THREE years have passed since Mahathir Mohamad stepped down, after governing Malaysia for 22 years. But the former prime minister is still finding it hard to adjust to retirement. After griping behind the scenes for the past year he has, in recent weeks, launched several fierce public attacks against Abdullah Badawi, the man he chose as his successor.

In Mr Mahathir's latest outburst, in a newspaper interview published on June 12th, he said “something has gone very wrong” in Mr Badawi's government. He hinted at corruption and implied it was under some sort of external control, without saying what that meant. He repeated his demands for answers to various questions he has raised, including the awarding of permits to sell imported cars to people he says are not in the car-dealing business.

Last month, Mr Mahathir accused his successor of selling out the country and of lacking “guts”. This was after Mr Badawi scrapped his predecessor's plan to replace Malaysia's half of a causeway linking it to Singapore with an oddly-shaped half-bridge, which in turn followed failure to agree terms with Singapore for replacing the whole causeway. Mr Mahathir has also denounced changes made at Proton, a state-backed carmaker that was another pet project of his. Why was its motorcycle subsidiary sold to an Italian group for just €1, he demands to know. And why was Proton's boss sacked?

Mr Mahathir insists he is not trying to topple his successor. However, he now publicly regrets choosing Mr Badawi. He says he should have picked Najib Razak, the deputy prime minister. So far, at least, Mr Najib and other leaders of the ruling United Malays National Organisation are rallying round Mr Badawi. Some accuse their former master of suffering from “post-prime-ministerial syndrome”.

The mild-mannered Mr Badawi has reacted calmly, leaving his underlings to snap back. But if Mr Mahathir's attacks continue, he may be forced to lash out to avoid looking weak. Mr Badawi won a strong personal mandate in the 2004 general election but he lacks his predecessor's strong hold over the governing party. His tough but sensible decision to cut fuel subsidies has cost him public support.

Mr Badawi's sin is not that he has deviated from the policies of the Mahathir era. Quite the opposite: it is his failure to go far enough. Little has been done to tackle the graft and cronyism that flourished under his predecessor. The national five-year plan that Mr Badawi announced with great fanfare on March 31st did not dismantle Malaysia's expensive and unsuccessful positive-discrimination scheme for ethnic Malays. And his promised reforms of the country's police have got nowhere, as shown by their brutal attack last month on a demonstration against fuel prices.

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Australia

No wedding bells

Jun 15th 2006 | SYDNEY
From The Economist print edition

John Howard blocks Canberra's gay marriages

Get article background

ALTHOUGH laid-back Sydney is Australia's gay capital, it was left to more staid Canberra to introduce the country's first law allowing gay and lesbian couples to form civil unions. The legislative assembly in the Australian Capital Territory (ACT), the region comprising Canberra, passed its Civil Unions Act last month, giving formal recognition to same-sex partnerships. When John Howard, the prime minister in Australia's conservative coalition government, threatened to overturn it, the territory's Labor-led government brought forward its commencement date to late June. But Mr Howard got in before the first gay couple could step forward. On June 13th Michael Jeffrey, the governor-general, who represents Queen Elizabeth, Australia's head of state, rejected the law on Mr Howard's advice.

Mr Howard argues the ACT's law unacceptably equates gay civil unions with marriage. Two years ago, during an anti-gay-marriage campaign in America that was barely echoed in his own country, Mr Howard drove through parliament an amendment to the federal Marriage Act defining marriage as a union between men and women “to the exclusion of all others”. Labor included the civil-union legislation in its successful ACT election campaigns in 2001 and 2004. Simon Corbell, the ACT's attorney-general, says he made 63 amendments during its drafting to avoid conflict with the Marriage Act. He accuses Mr Howard of “trashing” the ACT's power to make its own laws. Further attempts by the ACT are likely.

Since the ACT gained self-government, in 1988, federal governments have left it alone. Canberra's small (320,000) but influential population of academics, bureaucrats and policy wonks is unlikely to welcome this interference, especially since it came through a mechanism that saw a representative of the British monarch overrule their law: Canberra voted yes in a 1999 referendum to ditch the monarchy, when Australia as a whole said no.

Yet it is not the first time Mr Howard has intervened in regional laws hinging on moral and human-rights issues. In 1997, he initiated federal legislation to override another self-governing territory, killing off a Northern Territory law allowing voluntary euthanasia. Last year, his government passed the Suicide-Related Material Offences Act, making it a federal offence to use the internet or telephone to counsel or incite suicide. All three moves sit a bit oddly with the free-market and small-government ideals of which Mr Howard is perhaps Australia's biggest champion.

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Israel and Palestine

Hamas in a bind

Jun 15th 2006 | JERUSALEM AND RAMALLAH
From The Economist print edition

The Palestinians' Hamas government is increasingly besieged. But it is clinging to power, and to its policies

Get article background

CRITICS of the international boycott imposed on the Hamas-ruled Palestinian Authority (PA) until it recognises Israel are grudgingly having to admit one thing: it has weakened Hamas, as intended. The PA's financial crisis prompted a multi-party “national dialogue” in April. That inspired Marwan Barghouti, a jailed militant from Fatah, the party that used to rule the PA. He convinced some fellow detainees from Hamas and other groups to sign a document, in May, that called for a coalition government and implicit recognition of Israel. The Palestinian president, Fatah's Mahmoud Abbas, called on Hamas's leaders to accept the document; they stalled. Last weekend he set July 26th as a date for a referendum on it. And now Hamas, once a model of unity and discipline, is showing its rifts as never before.

You can count up to six Hamas leaderships: the notional chief, Khaled Meshal, in exile in Damascus; the PA government's main heavyweights, including the prime minister, Ismail Haniyeh, in the Gaza Strip; the rest of the government, in the West Bank; the convicted prisoners in Israeli civilian jails; the unconvicted, in long-term “administrative detention” in Israeli military jails; and the heads of its armed wing, the Izz ad-Din al-Qassam Brigades. While Hamas was in opposition, each bit faced similar pressures. Now in government, the pressures—and priorities—have shifted.

One split arose over the prisoners' document. The West Bankers, locked in talks with other parties, agreed to it as a basis for further talks without first checking with Gaza and Damascus, says Qays Abdel Kerim, a member of a small centrist party, who also took part. Even among the West Bankers there are differences. Ziad Dayyeh, a city councillor who represented Hamas in the talks, says it is willing to continue them, though there are things in the document it cannot accept. If there is a referendum, he says, Hamas will call for a boycott. However, Khaled Suleiman, who leads Hamas's parliamentary block in the West Bank, says that “the mainstream is moving towards accepting the prisoners' document as a general framework, with some minor modifications.”

Another disagreement appeared after seven people died in an explosion on the Gaza beach, which the Palestinians attribute to an Israeli shell. (Human Rights Watch, a New York-based lobby, which sent a team to the site and talked to victims and doctors, agrees. Israel's army, after studying photographs and news footage from the scene and checking the timings against its firing records, says it was a buried Palestinian mine.) In response the Qassam Brigades said they would start suicide bombings in Israel again after a 16-month lull, and launched a flurry of rockets into Israel, injuring one person. Mr Meshal sided with them. But Ahmad Yusuf, an adviser to Mr Haniyeh, said that renewing attacks “does not serve the interests of the Palestinian government”.

For sure, Mr Abbas's referendum move has wrong-footed Hamas. Opinion polls say Palestinian support is high for the prisoners' document and falling for Hamas. Dithering, Hamas has suspended the talks, insisting that they move from Ramallah, the West Bank's administrative capital, to Gaza, where, presumably, Hamas would keep tighter ideological control.

Still, Hamas's problem may be less with the prisoners' proposal itself—a frequent refrain is that “we agree with 90% of it”—than with Mr Abbas's tactics. “They think that any step Fatah takes is meant to overthrow them,” admits Qaddoura Fares, a Fatah leader close to Mr Barghouti. Having won an election only in January, Hamas is reluctant to cede authority. Indeed, even if Mr Abbas sees the referendum as a genuine chance to bring the rival factions together under a common banner, some in his party hope it will prompt Hamas's fall, an election, and Fatah's return to power.

But these are rose-tinted views. First, there is no guarantee that a referendum will happen. Hamas is planning every legal and political obstruction it can think of. It is unclear where the money to hold a plebiscite would come from. And bits of the PA security forces loyal to Hamas and those loyal to certain Fatah leaders with an interest in sowing disruption are sporadically clashing. A well-timed bout of violence could derail the exercise.

Second, what if the vote succeeds? Mr Fares says some Hamas ministers have told him they would quit the government and force a new election. Fatah is far from assured of winning such an election; and even if it wins, far from assured of governing successfully for long. Though re-energised by Hamas's woes, it has done little about its own corruption and internal feuds since losing power.

Even if Hamas caves in, and agrees to the document and a coalition, what power will that give Mr Abbas? Mr Yusuf has said that Hamas has no problem even now with Mr Abbas talking to Israel. But Israel says the document changes nothing, since it falls far short of the conditions the world has set for ending its boycott. And this week Ehud Olmert, the Israeli prime minister, got guarded approval from his British counterpart, Tony Blair, for going ahead with a unilateral Israeli withdrawal from the West Bank if there is no progress in peace talks. His coalition is fragile, so he will want to press ahead with the plan, on the strength of which he was elected, as fast as possible. A PA still partly run by Hamas or by a powerless president would be a perfect excuse for doing that.

“Nobody expects [the referendum] to change Israel's position,” says Mr Abdel Kerim. “But it will deal a blow to the Israeli pretext that there's no Palestinian partner.” His hope, and that of left-wing Israelis, is that if Mr Abbas got a solid vote of confidence—proving that Palestinians, though they voted for Hamas, were not voting for Israel's destruction—Mr Olmert would face irresistible pressure abroad and at home to put the withdrawal plan on hold.

Mr Olmert says he will sit down with Mr Abbas “within a few weeks”. But what would they talk about? A Palestinian state with provisional borders, essentially a negotiated version of the unilateral withdrawal, which Mr Olmert says is “unpreventable” and will happen “with or without talks”? No way, says Mr Abbas.

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Iraq

A chance for the new man

Jun 15th 2006
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The prime minister's good start

NURI AL-MALIKI took a long time to get going, but, at least for the time being, Iraq's new prime minister is on a roll. In contrast to his dithering predecessor, Ibrahim al-Jaafari, Mr Maliki has looked a lot more decisive. Moreover, in the words of a Western diplomat, “he talks less and listens more.”

Two weeks ago he flew down to Iraq's biggest southern city, Basra, to impose a state of emergency and knock together the heads of quarrelling Shia factions whose bickering had contributed to a security breakdown. Then he managed at last to appoint defence and interior ministers who, in the hope of reducing sectarian bloodshed, are not unduly beholden to any of Iraq's main political parties. He also announced the imminent release of 2,500 or so prisoners, most of them Sunni insurgents, as part of a national reconciliation plan which may come to include an offer of a wider conditional amnesty.

This week, in the wake of last week's killing of the self-proclaimed leader of al-Qaeda in Iraq, Abu Musab al-Zarqawi, Mr Maliki sent some 75,000 American and Iraqi troops into Baghdad's streets to hunt for other insurgent chiefs. And President George Bush's surprise visit to Iraq on June 13th, apparently unbeknownst to Mr Maliki until the last minute, capped America's approval of the new man, whose forceful leadership has so far been tempered by a more concerted effort to reach out to Iraq's disaffected Sunni Arabs. At the same time, Mr Bush reassured him that American troops would not leave “before [Iraqi government forces] are capable of defending themselves”.

But Mr Maliki's new government still faces an uphill task. According to body counts in the morgues, a combination of the insurgency, sectarian conflict and ordinary crime made last month one of the bloodiest since the American invasion three years ago. Massive security sweeps, such as the one now going on in Baghdad, have had a patchy record. Last year, in Operation Lightning, the detention of many hundreds of Sunni Arab civilians polarised Baghdad and probably increased the violence. This time, however, Mr Maliki says his troops will be more careful. Among other ideas, he wants to introduce more distinctive uniforms for the security forces so that citizens have a better idea whether a uniformed group of troops is a legitimate unit or a death squad.

After many last-minute rejections, Mr Maliki's choices as interior and defence ministers have been generally well received. The interior minister, Jawad al-Bolani, a Shia, served in Saddam Hussein's air force until 1999. Though close to a southern Shia leader, Abd al-Karim al-Muhammadawi, he is not tied to either of the two biggest militia-backed Shia movements—the one loyal to Muqtada al-Sadr and his Mahdi Army, the other to the Supreme Council for Islamic Revolution in Iraq and its Badr Brigades—whose armed men are alleged to have carried out hundreds of sectarian killings.

The new defence minister, Abd al-Qader al-Mifarji, left Mr Hussein's army as a general in 1991 but, after rejoining a few years ago, first led a new unit of commandos, then led another military force against insurgents in the disaffected province of Anbar, west of Baghdad. Mr Maliki chose this pair over the objections of some of his Shia allies who said that he was bending too far to placate their former Sunni oppressors.

So far, the new government, which includes Sunni figures who claim connections to various insurgent groups, has yet to establish even local ceasefires with any of them. Beyond trying to improve security in Baghdad and Basra, Mr Maliki will also have to move fast to tweak the constitution, if he is to embrace disaffected Sunni Arabs. On that score, he must ensure a fairer distribution of oil revenue than last autumn's constitution implies, and assure Sunnis that any Shia region, for instance in the south, will comprise no more than three or four of Iraq's 18 provinces, not the mooted nine-strong Shia “super-

region” that Sunnis fear would presage the country's final break-up.

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Nuclear diplomacy with Iran

Make or break?

Jun 15th 2006
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The message from Russia and China

WILL Iran take up the offer of negotiations over the future of its nuclear programme? In public at least, diplomats from America, Britain, France, Germany, China and Russia are holding their breath. Iran continues to ponder the package of incentives the six countries put to it last week. The hope is that any hard bargaining will be under way before the G8 summit (involving the G7 rich countries plus Russia) in St Petersburg in mid-July.

This week, the 35-nation board of the International Atomic Energy Agency (IAEA), the United Nations' nuclear guardian, had before it yet another report listing inspectors' concerns about Iran's nuclear activities. But the real action was elsewhere. Iran's outspoken president, Mahmoud Ahmadinejad, was in China, quietly sitting in on a meeting of the Shanghai Co-operation Organisation, which includes four Central Asian states and Russia too. The behind-the-scenes messages he and other officials are getting from Russia and China over Iran's nuclear ambitions may determine whether the nuclear diplomacy can succeed.

Both countries have been reluctant to press the other element of the agreed package: economic, financial and political sanctions. But without real costs to weigh against its nuclear plans, Iran will have little reason to consider the suspension of uranium enrichment and plutonium dabbling (both are usable for nuclear fuel-making but abusable for bomb-making) that the Europeans and others have made a condition for negotiations.

Plenty of countries, including Russia and China, but also Japan, India and Malaysia, that trade heavily with Iran are still chary of sanctions, unless ordered by the UN Security Council (where Russia and China, Iran notes, have vetoes). America, meanwhile, has been leaning on foreign banks to curb their dealings with Iran. This week, it added five companies (four in China, and another in the United States but representing a Chinese outfit) to its list of those fingered for assisting Iran's weapons programmes and so banned from doing business with American companies.

When Iran does reply, it is unlikely to give a straight yes or no. It has hinted at counter-proposals to include continued enrichment work, while perhaps accepting temporary restrictions on the number of uranium-spinning centrifuge machines that it operates.

That, Western negotiators stress, is a deal-breaker. A suspension of enrichment work is key to the diplomatic package and a precondition for America to join in direct talks for the first time. In any case, letting Iran continue enriching while talking, says Gary Samore of the Chicago-based MacArthur Foundation, would be an “exercise in futility”. The proposals put to Iran allow for such work to resume only when IAEA inspectors are completely satisfied that its programme is entirely peaceful.

At the rate Iran is going, that could take years. After two decades of lies and cover-ups, inspectors still doubt its explanations about past uranium and plutonium work and worry that it may have imported more advanced centrifuges than it has owned up to. They also have suspicions about military links to its nuclear programme, and about work on high-explosive bomb triggers and a potentially nuclear-capable missile cone. This fuels suspicion that Iran really wants a bomb, or the capacity to build one at speed.

Iranian officials acknowledge that, once the techniques for making uranium and plutonium are fully mastered, the only difference between a civilian nuclear programme and a military one is intent. They also insist they have an “absolute right” to nuclear technology. But no one is asking Iran to abandon its nuclear-power programme—all it claims to want. Alongside other economic inducements and security

talks that could at some stage involve America, last week's package includes offers of co-operation on other advanced nuclear technologies, including reactor construction and agricultural and medical research, and guaranteed fuel supplies.

Searching for a compromise, one idea in the air is for Iran to go on spinning its centrifuges but using inert gas rather than uranium. But that, says David Albright of the Institute for Science and International Security, a Washington think-tank, would leave it free to practise the tricky art of keeping centrifuges spinning for long periods. Whether or not Iran has a hidden military plan, these are just the skills it would need to keep a weapons option open.

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Kenya

Bling-bling boys from abroad

Jun 15th 2006 | NAIROBI
From The Economist print edition

An odd saga with Armenians has mocked the government

Reuters

I'm only on safari

"THE last six days have been humiliating for this nation," opined Kenya's *Standard* newspaper this week. "Our sovereignty has been violated. Our nationhood has been insulted. Our borders have been encroached by hostile forces."

Earlier this year two men claiming to be Armenian brothers, confusingly calling themselves Artur Margariyan and Arthur Sargsian, came to the nation's attention. They were alleged, said Kenya's opposition politicians at the time, to be mercenaries responsible for organising raids by police commando units on television and newspaper offices. The raids were supposedly an attempt to muzzle Kenya's largely free press by powerful figures in the embattled government appointed by President Mwai Kibaki—and specifically to stop investigative reporting on government corruption.

It was the Armenians' style that caught the eye. They were not mercenaries, they insisted, but worthy businessmen involved in property, diamonds and a night club. Their bling-bling image—dark glasses, gold chains and wads of cash—delighted Nairobi's hip-hop crowd and appalled others, particularly those whom the Armenians came up against. The brothers' claims to be relatives of Armenia's president sounded shaky. Some even doubted whether they were Armenian at all.

They certainly seemed to have protectors high up in Kenya's government. But it was only after the two men allegedly pulled guns on customs officials at Nairobi's main airport last week that the extent of their ties was revealed. The police commissioner, Hussein Ali, had them deported on June 9th and their Nairobi house and buildings searched. Inside, according to police reports, were a Mercedes with government licence plates, AK-47 machine guns with presidential security unit serial numbers, Ceska automatic pistols, Kenyan passports bearing the photos of the Armenians but with other names, a document appointing one of the men a Kenyan police detective, plus masks and jackets similar to those used in commando raids on the media outlets. Among other items was a security pass granting the Armenians access to secure areas of the airport; this, along with the alleged way the men claimed a piece of luggage at gunpoint, particularly upset diplomats, some of whom reckon that Nairobi and its airport remain a target for jihadist terrorist plots.

Distancing himself from the Armenians, Mr Kibaki has suspended several senior policemen and immigration and airport officials. An inquiry may reveal who the Armenians really were, what they did and whether they were in the pay of the government. It is unlikely to improve the government's reputation or help the forlorn, indecisive Mr Kibaki.

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Zambia

It's looking up a bit

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From The Economist print edition

Zambia has managed to avoid the crises plaguing its neighbours

AN UNUSUAL message has been airing on the radio in Lusaka, Zambia's capital. A local garage is advertising lower prices, thanks to the strength of the local currency, the kwacha. By contrast, Zambia's neighbour to the south, Zimbabwe, has the world's top inflation rate: at last count, 1,194% a year. Zambians used to go there to seek their fortune; now it is Zimbabweans who try to sell their wares on Lusaka's streets, while white Zimbabweans, resettling to the north, have made Zambia's tobacco output soar. In the past, Zambia had other turbulent neighbours, such as Angola, Mozambique and the Democratic Republic of Congo, all ravaged by civil wars. Yet, despite getting steadily poorer, Zambia has remained remarkably stable. And now even its economy is perking up. Last year, as a reward, donors wrote off $3.9 billion of its foreign debt. Most of the savings, thanks to Zambia's lower debt-service burden, are going on recruiting teachers and improving health care.

Surging foreign investment, high copper prices and aid cash have pushed the kwacha unexpectedly high; inflation has fallen to under 10% for the first time in years; the economy is expected to grow by over 6% this year; and good rains and a global commodity boom are helping too.

But the government also deserves credit. President Levy Mwanawasa is following the path of his predecessor, Frederick Chiluba, who turned a state-controlled economy into a more market-oriented one. The government has done well to reduce the budget deficit. Now it is keen to use higher copper prices to build a more diverse economy. Tourism is doing well, with visitors preferring Zambia's side of the Victoria Falls to Zimbabwe's. The government has also successfully encouraged tobacco farming and horticulture.

Yet Zambia is still ill-equipped to weather a changing wind. Copper still accounts for over two-thirds of exports, and one day prices will dip. The country sits on over 40% of the region's water, but too many of its farmers still depend on erratic rains. Zambia remains very poor and relies heavily on aid, which can be fickle. The sudden rise in the kwacha may hurt commercial farming and tourism.

But benefits from the stronger economy have begun to trickle down to the poor. Since the government recently scrapped fees in rural clinics, the daily load of patients in some places has doubled. Such improvements should help Mr Mwanawasa's chance of re-election. Polls are expected this year, though no date has been set. In 2001, he was elected by a thin margin and with less than 30% of the vote. Foreign observers frowned on the election, and the opposition disputed the result in a court case that dragged on for three years.

Katele Kalumba, the energetic national secretary of the ruling Movement for Multiparty Democracy (MMD), is hoping for a plainer result this time. But the MMD is still recovering from Mr Chiluba's failed attempt to seek a third term, which divided the ruling party. Accusations of tribal bias at the top have created new tensions. Mr Mwanawasa was handpicked by Mr Chiluba, but once he became president he launched an ambitious anti-corruption drive that hit his benefactor and Mr Chiluba's former protégés. The new president's critics say this has turned into a political witch-hunt and that he is doing little to tackle pervasive petty corruption. Many Zambians, who first welcomed Mr Mwanawasa's clean-up effort, are disillusioned.

The opposition is even more divided than the ruling MMD. The death last month of Anderson Mazoka, leader of the United Party for National Development, who almost defeated Mr Mwanawasa in 2001, is a big blow. A few opposition parties have joined ranks ahead of the election, but a single opposition candidate is unlikely and whoever gets most votes in the first round is elected. So the opposition is calling for a two-round system and for a president to be elected by at least half the electorate. The

government says no.

Even if Mr Mwanawasa is re-elected, the future is fuzzy. He has had two strokes. With potential rivals sidelined, he has no obvious successor in his party. Personal ambition rather than ideology shapes Zambia's politics: the prospect of nice jobs and perks may yet persuade some opposition leaders, many of them disgruntled MMD heavyweights, to rejoin the fold.

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Georgia, Ukraine and NATO

Surrounding Russia

Jun 15th 2006 | MOSCOW
From The Economist print edition

Russian worries about Western encirclement are premature

AP

Get article background

IT IS a decidedly odd race. Mikhail Saakashvili and Viktor Yushchenko, leaders respectively of Georgia's "rose" and Ukraine's "orange" revolution, are both eager to join NATO, despite grim warnings from Moscow about the dire consequences. The Georgians are desperate to get in, but are nowhere near ready. The Ukrainians look more eligible—except that most of Mr Yushchenko's countrymen do not much want to join.

Recent events in Crimea have encapsulated Mr Yushchenko's predicament. Multinational military exercises supposed to take place around the peninsula this summer do not in fact fall under NATO's auspices; similar ones have occurred for most of the past decade. Yet, after hysterical rumours were spread about the unloading of poison gases and about NATO coup plots, a ragtag mob of Communists and Cossacks blocked preparations for the exercises by a group of American reservists. The Americans left—and the latrines they came to dig remain undug.

Even in a country as wacky as Ukraine, Crimea is unusual: many of its Russian-speaking inhabitants would prefer it to be, as it was until 1954, part of Russia. Sebastopol is home to Russia's Black Sea fleet. The protests were also a by-product of the wrangle over forming a new government in Kiev, which has been going on ever since Ukraine's parliamentary election in March. NATO membership is a sticking-point in the political negotiations.

For all that, it seems clear that most Ukrainians do not want to join the NATO alliance. "Soviet brainwashing," retorts Anton Buteiko, a deputy foreign minister; yet Mr Yushchenko would struggle to carry a mooted referendum on accession. Apart from that hitch, its faster progress in military reform, better hardware and more troops ought to put Ukraine comfortably ahead of Georgia in the membership

stakes. The Georgians have made progress, though often more on paper than in reality. They have also tried to ingratiate themselves by helping out in Iraq. But Mr Saakashvili faces a deal-breaking problem of his own: that bits of his country are, in effect, under occupation.

As Alexander Rondeli of the Georgian Foundation for Strategic and International Studies puts it, Georgia is handily located on the Black Sea, “between oil-rich Russia and the oil-rich Islamic world.” It was once a conduit for narcotics and a refuge for terrorists. But geography also points to Georgia's main flaw. Two separatist enclaves, Abkhazia and South Ossetia, fought their way to quasi-independence in the 1990s, and have been sustained ever since by Russian support. Mr Saakashvili and Vladimir Putin, Russia's president, who have been trading insults for months, met in St Petersburg this week; but agreement on the enclaves is remote.

Mamuka Kudava, who leads Georgia's NATO campaign, says optimistically that joining NATO and sorting out the enclaves will go together. But Vyacheslav Nikonov, a Kremlin-friendly analyst in Moscow, declares that, if Georgia ever joins, it “can forget about South Ossetia and Abkhazia.” The Georgians complain that to make the enclaves a decisive factor in their bid would be to give the Russians a veto. Mr Kudava likens the situation to the border disagreements with Russia that Baltic members of NATO brought with them. But taking Georgia into NATO in its current shape might look more like offering insurance for a broken-down car.

In fact, bellicose Russian noises about Georgia and Ukraine joining are partly tactical. Statements last week by the Russian government and in the Russian parliament about the grave danger of Ukrainian accession may have been aimed, in part, at the coalition negotiations in Kiev. Mr Yushchenko detected a “third force” at work in the Crimean brouhaha. Some Russian parliamentarians, behaving more like comedians, were indeed at the scene.

Still, Russia's worries are partly genuine, and not altogether unreasonable. America would be concerned, argues Mr Nikonov, if Mexico and Canada were to join a military organisation led by Russia. Seen from Moscow, NATO expansion is beginning to look endless: the drive to “surround Russia with NATO,” says Dmitri Peskov, a Kremlin spokesman, will demand “counter-measures”. The Kremlin worries about the future of its Black Sea fleet, should Ukraine get in. But even more important than bases, says Dmitri Trenin, of the Moscow Carnegie Centre, would be the sense that NATO membership had permanently reoriented Ukraine out of Russia's sphere of influence.

The Kremlin need not panic yet. The Americans want to bring in both Georgia and Ukraine, but other NATO governments are less gung-ho. One reason is that some of the democratic sheen has come off both revolutions. Another is that many Europeans feel that the alliance is already big enough, and that some newer members joined too soon. Some members also do not want NATO to move further and faster than the European Union. And a few are against because they fear antagonising the Russians. (“Who cares about Georgia?” asks Mr Rondeli, gloomily.)

Mr Saakashvili and Mr Yushchenko are looking for a concrete foreign-policy achievement. For both, NATO membership looks more attainable than early entry into the EU. Mr Buteiko asserts that Ukraine might still join in 2008. But both countries may well find themselves lapping each other on a jargon-littered circuit of “dialogue” and “action plans” for a lot longer than that.

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The Baltics and NATO

Small world

Jun 15th 2006 | TALLINN
From The Economist print edition

Doubts about Baltic membership of NATO have subsided

Get article background

TOO small, too risky, and too unprepared. That was how NATO saw the Baltics in the 1990s. Their armed forces were an ill-equipped, untrained and sometimes disreputable lot. Bad old habits lingered from the Soviet era (bullying, alcoholism) and bad new ones had been picked up (mutiny, corruption). So why, many asked, should NATO extend its defence guarantee to such troublesome and useless allies?

Yet two years after Estonia, Latvia and Lithuania joined the alliance, things look rather different. Russia's huffing and puffing over the Baltics joining NATO has proved empty. NATO's practical commitment is cheap and minimal: just four foreign fighter aircraft, based in Lithuania. In return, NATO has gained a few things. Lithuania has useful special forces; Western spies speak highly of their Estonian colleagues. Estonia and Latvia have modern radars that snoop deep into Russia and Belarus. “You can see things from here that you can't see from Norway,” says Sven Mikser, a former Estonian defence minister.

Another plus is tough soldiers and supportive politicians—nowadays a rarity in Europe. “The quality is much higher than we have at home,” says one Western adviser. “They have ordinary soldiers with degrees, who speak three languages.” Boots with brains come in handy for the Balkans, and farther afield: scores of Baltic soldiers have served in Iraq, and hundreds in Afghanistan. They have “liberal rules of engagement, coupled with tough self-control,” says Kadri Liik, director of Estonia's International Centre for Defence Studies.

The Balts are also well placed to advise other countries how to turn rough-and-ready, ramshackle armies into something more professional. At the Baltic Defence College in Estonia, officers from Ukraine and Georgia study alongside locals. It is admittedly small stuff compared with Poland, the biggest, strongest and most useful new NATO member. The Balts still need to treat their soldiers better, and to increase defence spending (though so do bigger and richer members from western Europe).

The biggest lesson of bringing the Balts in is that it resolves security problems that might otherwise fester. “If they weren't in NATO, there would now be a huge tussle for influence here between the West and resurgent Russia,” says a veteran observer. “Because the Balts are in, it's not really an issue.”

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Spain and its regions

Let's all pull apart

Jun 15th 2006 | MADRID
From The Economist print edition

After the Catalans, Basques and Andalusians want autonomy too

WILL Catalans turn out to vote, or will they head for the beach? After months of debate over a new charter of autonomy, many may choose the latter when it is put to a referendum on June 18th. Yet there is no doubt about the result: the charter will sail through. Only the conservative People's Party, harder-line separatists and a handful of anti-nationalist intellectuals are against.

Spain's Socialist prime minister, José Luis Rodríguez Zapatero, should emerge smiling. The People's Party predicts the disintegration of Spain after a "yes" vote. But Josep Durán i Lleida, spokesman of the moderate Catalan nationalist Convergence and Union coalition, which backs the charter, retorts that "there is no danger of Spain falling apart, nor is this a first step towards independence." Indeed, separatists complain that the charter is too weak—they wanted Catalonia formally recognised as a "nation". Other critics fret over a new duty for people to understand Catalan, which will now be obligatory for most public-sector jobs. Another complaint is that what is billed as Catalonia's "constitution" is so long. With 227 detailed articles, running to 57 pages, it rivals the European Union's failed constitution.

But the new charter's biggest impact may be beyond Catalonia. This is only the start of a round of revising the charters of most of Spain's 17 autonomous regions. Catalonia has raised the bar. Other regions, which got fewer powers when the Spanish constitution was adopted in 1978, hope to catch up. Andalusia wants to be recognised as having a "national reality". But in truth, nobody wants to be left behind.

That will affect most notably the Basques, who currently enjoy even more powers than the Catalans. It is hard to predict the effects of a Catalan yes on the slow-moving peace process in the Basque country. Basque nationalists, including erstwhile ETA terrorists, could take the Catalan route of negotiations with Madrid. In the past, however, the dynamic of Spanish regionalism has required that, whatever others have, Basques and Catalans should have more. So Basque nationalists, seeing Andalusians hard on their heels, may demand a lot more. But a right to self-determination has already been ruled out by Mr Zapatero. And if the People's Party is angry about the Catalan charter, it is even more hostile to negotiations with ETA.

This will limit Mr Zapatero's room for manoeuvre with the Basques. Unlike peacemakers in Northern Ireland in the 1990s, he will not have bipartisan support from his main opposition party. That may, however, produce an unintended pay-off, in the form of a political "good cop, bad cop" scenario. ETA's choice may be to deal now with the good cop Zapatero—or to suffer, at some point in the future, from the intransigence of a bad cop People's Party.

A Catalan "yes" will remind Basques of the work they still have to do, but it should at least allow Catalans to relax. The new charter ought to last for a couple of decades, at least. "We won't be able to go back to it during our political lifetime," says Mr Durán i Lleida.

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Turkey and Armenia

The ties that divide

Jun 15th 2006 | KARS
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Locals dream of reopening the frontier between Turkey and Armenia

NAIF ALIBEYOGLU, mayor of Kars, a town bordering Armenia, has a dream. He pictures a party of Turkish officials embracing their Armenian counterparts in the middle of an ancient bridge over the river that divides their countries. Reduced by war and neglect to a pair of greyish stone stumps on opposite banks of the river, its condition is an apt symbol for relations between the two countries. The bridge, part of the historic site of Ani (see article), would in theory be easy to reconstruct. Fixing the broader relationship between Turkey and Armenia promises to be a great deal harder.

Turkey was among the first countries to recognise Armenia when it emerged from the Soviet Union's wreckage in 1991. But bitter arguments over the fate of the Ottoman Armenians—did the mass killings of 1915 constitute genocide?—together with lingering border disputes have stood in the way of formal ties. The estrangement deepened in 1993 when Turkey sealed its land frontier with Armenia (while still allowing direct air travel). The Turks acted after Armenian forces had occupied a chunk of Azerbaijan in a war over the enclave of Nagorno-Karabakh.

Years of secret talks between Turkish and Armenian diplomats—the latest of which were held in Vienna in March— have failed to ease tensions. And this is despite vigorous backing for renewed ties from both America and the European Union, which Turkey is seeking to join.

Mr Alibeyoglu, who is from Turkey's ruling AK party, says the people of Kars are paying the price. With average annual incomes of only $823, Kars is among the country's poorest and most neglected provinces. Yet before the cold war Kars was among the young republic's most progressive places. It is vividly evoked in “Snow”, a novel by Turkey's most famous writer, Orhan Pamuk. Locals would attend the theatre and ballet and dine on caviar and champagne. Such tastes were inherited from former Russian occupiers, whose traces can still be detected in the grandeur of its Tsarist-era architecture.

Mr Alibeyoglu, whose penchant for wine and naughty sculptures would have gone unnoticed in those days, now sees a chance to reverse his city's decline, but only if Turkey unconditionally reopens its borders. By doing this, Turkey would regain some moral high ground, as well as securing access to strategic markets in Central Asia and beyond. Kars could even become a regional hub in the Caucasus, especially if a rail link to Armenia's capital, Yerevan, were restored. Trade volumes between the two countries, now averaging a measly $100m a year, almost all of it conducted via Georgia, should soar.

There is more. As many as 200,000 members of the Armenian diaspora return to their homeland every year. Many would like to cross the border into Turkey in order to visit Armenian archaeological sites. The tourist trade could be worth millions of dollars. “They would also meet Turks and realise they aren't quite as evil as they imagined,” adds Kaan Soyak, co-chairman of the Turkish-Armenian Business Development Council.

But how to break the diplomatic deadlock? Mr Alibeyoglu's answer is to take matters into his own hands. In 2000 he drove to the Armenian town of Gyumri, where he appeared on television with his fellow mayor and appealed for peace. This autumn, Mr Alibeyoglu will host a festival that features, for a second time, performers from Armenia, Georgia and Azerbaijan. The Armenians will have to make a tortuous journey via the Turkish cities of Trabzon and Istanbul. But the mayor hopes that, one day soon, their journey will be much quicker.

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Ani, a disputed city

Haunted by history

Jun 15th 2006 | ANI
From The Economist print edition

The ruins of a contested capital are still hostage to geopolitics

WHATEVER you think about ghosts, it is hard to speak of this desolate plateau on Turkey's eastern edge without using the word “haunted”. A millennium ago, Ani rivalled Byzantium as one of the great cities of the Christian world. At its height, the Armenian capital had over 100,000 inhabitants. Now all that stands is an impressive wall, and the gaunt but beautiful remains of churches and mosques randomly scattered across a vast expanse of grassy earth. On a hot day in early summer, with flowers blooming and birds swooping through the ruins, the place is utterly empty.

Ani's location at one of Eurasia's nodal points, where rival civilisations either clash or co-operate, has been both a blessing and a curse. The “silk route” linking Byzantium with China ran through it. But less than a century after it became the Armenian capital in 961, the city began falling victim to waves of conquerors, including Seljuk Turks, Georgians and Mongols. In 1319 it was devastated by an earthquake.

Even as a ruin, Ani has been a disputed city. In 1921 when most of the site was ceded to Turkey, the Armenians were dismayed. They have since accused the Turks of neglecting the place in a spirit of chauvinism. The Turks retort that Ani's remains have been shaken by blasts from a quarry on the Armenian side of the border.

Turkey's authorities insist that they are doing their best to conserve and develop the site. “By restoring Ani, we'll make a contribution to humanity,” says Mehmet Ufuk Erden, the local governor. “We will start with one church and one mosque, and over time we will include every single monument.” The culture ministry has listed Ani, with an Armenian church on an island in Lake Van, among the sites it is keenest to conserve. For a country that was reluctant, until recently, to accept the cultural heritage of non-Turks, this is a big change.

But some scholars say more is needed. “Piecemeal restoration is no substitute for a master plan for Ani as a whole,” argues Stefaan Poortman of the Global Heritage Fund, a California-based conservation group that helps to manage endangered historic sites. And making a master plan for a site straddling two countries is impossible unless they co-operate. Could it happen? In September, some 14 Black Sea countries hope to meet in Istanbul to dicuss their cultural heritage. So Turks and Armenians will get a chance to talk about Ani, if history's ghosts can be exorcised.

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Charlemagne

Could do better

Jun 15th 2006
From The Economist print edition

The annual report of the European Union as a club

“THE past six months have seen considerable progress at the club, even though it has been somewhat harder to keep up standards since our French and Dutch members voted not to endorse the proposed new articles of association last year. Partly because of this, the agenda is disappointingly thin for this week's full board meeting, chaired by our Austrian colleague (*Sachertorte* will be served).

The club's main function is to provide level playing fields on which members can compete against each other in friendly matches and occasionally field teams to take on clubs elsewhere in the world. We suffered our tenth successive defeat in our yearly attempt to wrest the Lisbon Cup back from our friends at the American Capitalist Association. Our 15-0 thrashing at the hands of the Mandarin Traders' Club has led to demands for withdrawal from this fixture (Mr Mandelson has been asked to look into complaints of unfair competition). But at home, our Nordic members' style of play was particularly admired.

The committee is continuing to make improvements to the clubhouse. In May, our council approved a new service contract for the cooks, waiters and cleaners—the first foray into services in the club's history. Some members, especially those who joined in 2004, demanded a more comprehensive contract but the committee hopes that the one we negotiated will improve levels of service, which have been lagging. A few members still want the club's Polish plumbers sent home. Members should note that the use of mobile phones is encouraged throughout club premises and that the committee is seeking to reduce the cost of making calls. We are also buying more television sets for the sedentary members who prefer watching football to playing it.

Upgrading the clubhouse has required some modernisation of our finances. The budget adopted by the board of governors last December was finally approved in May, and will come into force next year. Worries that the new financial arrangements could penalise our newer members have proved unfounded. The executive committee believes that the budget will set the club on a sound financial basis for the next seven years, without any increase in fees. Some members, however, argue that there should have been a more thorough financial review; and our British colleagues, in particular, complain that too much money is still spent on the gardens and fields. To keep them happy, the executive committee will look at this again in 2008.

When the articles of association were rejected, many feared that the club's ability to keep the facilities for members up to scratch would be impaired. The committee is happy to report that this has not happened. Instead, we propose to expand our authority into three areas. First, the club at considerable expense will install a new heating system, which will, we believe, produce better results in the long term than the current exclusive contracts many of us have with Mr Gazprom from Russia, about whom there have been several complaints. Next, the committee would like members' approval to a streamlining of the arrangements for negotiating reciprocal arrangements with foreign clubs. Meetings with others can be embarrassing because our delegation often has more people than chairs: the executive committee secretary, the official responsible for ties with other clubs, representatives of the board of governors and so on.

Lastly, the committee has been alarmed by a recent crime wave. We are also concerned about members' reluctance to report suspects to the committee and to other members. We are seeking an improved security system for the clubhouse, and we ask members, if they have any information regarding suspected burglars, in particular, please to share it with the committee, and not keep it to themselves.

The committee is pleased to say that the club remains as popular as ever with outside applicants. We have received one new application for membership this year (from Montenegro). The committee is to decide in November when to extend full membership rights to our country cousins in Romania and Bulgaria. The committee has also begun to canvass members' opinion on pending applications from Turkey and Croatia, though it regrets to say that some of these opinions are negative. It was only with great difficulty that we managed to persuade members from Cyprus not to blackball our Turkish friends—or, at least, not yet.

As members can see, the list of achievements for the past year is long and should help to moderate recent complaints about low morale and a lack of direction in the club. It may be reasonable to disagree with some of the club's decisions—as many members do—but it would surely be wrong to complain that nothing has been done at all.

The sting in the tail

Even so, the committee would like to conclude its annual report with a word of caution. Many members argued that, without the articles of association, the club would not be able to do anything. That fear has proved wrong. Now, the same members tend to say that, without the articles, any decisions that are made may damage the club's long-term interests, since partial progress may make it harder to implement the articles of association in full. The committee believes that this fear, too, is unwarranted.

Sometimes it is desirable for the club to have a grand project to keep its members interested—such as our special system of club payments, introduced in 2001, or the big membership drive that bore fruit in 2004. But sometimes, as John Calhoun, a member of America's Capitol Hill club long before our own club was even dreamt of, once said, “the highest wisdom...is, a wise and masterly inactivity.” Our club surely does not need big new plans merely to create an impression of action, heedless of the members' wishes or concerns—unlike some other clubs we can think of. Thank you. Now perhaps we can save any questions until after dinner.”

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Fighting child poverty

A long way to go

Jun 15th 2006
From The Economist print edition

Report Digital

Labour has focused too much on benefits and not enough on work

GOVERNING parties often define their purpose when they are in office rather than in opposition. Margaret Thatcher discovered the virtues of privatisation some time after winning power in 1979. Labour launched its crusade against child poverty almost two years after its victory in 1997.

Speaking at Toynbee Hall in east London in March 1999, Tony Blair startled his audience with a pledge to end child poverty within 20 years. The government subsequently set two ambitious targets as milestones on the journey: to have reduced the number of poor children by at least a quarter in 2004-05; and to have cut it by half in 2010-11.

Child poverty, conjuring up images of Victorian paupers like Tiny Tim, is an emotive term for what is now a relative measure of income inequality rather than an absolute indicator of destitution. The government counts children as poor if they live in families whose net income is below 60% of the median household's. Estimating this poverty line is complicated, and the government is adopting new methods to do so (see article).

According to the way poverty has been calculated until now, 3.1m children were poor in 1998-99, the financial year ending in March 1999, when Mr Blair made his pledge. Since there were (and are) some 12.5m children in Britain, a quarter of them were poor. Indeed, if housing costs are taken into account, an alternative measure that the government has also been using, 4.1m were poor, a third of all children.

Since 1998-99 the number of poor children has fallen by 700,000, an impressive decline but not enough to meet the first target of reducing child poverty by a quarter. In 2004-05 there were 2.4m poor children, 100,000 above the goal of 2.3m when measured before housing costs, and 3.4m poor children after housing costs, 400,000 more than the milestone of 3m.

The failure to hit the target might seem a quibble given the big decline in the number of poor children. It represents a genuine setback, however, because Labour has shunted so much money towards poor families in the past few years. In particular they have been helped through a new system of tax credits which cost £15.8 billion ($29.2 billion) in 2004-05, eclipsing the long-established child benefit paid to all

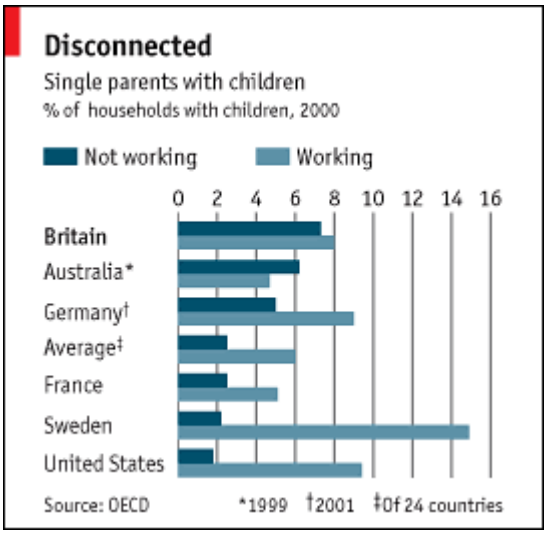
families, which cost £9.6 billion. Altogether, Labour's policy changes have pushed up transfers to families—mainly poorer ones—by nearly 1% of GDP since Labour took office, says Mike Brewer of the Institute for Fiscal Studies.

Further big increases in financial support no longer appear affordable. This will make the government's next target—cutting child poverty between 1998-99 and 2010-11 by half—even harder to hit than its first one. Under the revised definition of the poverty line that will now be used, the number of poor children fell by 600,000 between 1998-99 and 2004-05. It will have to fall by a further 1m to hit the target in 2010-11, according to Mr Brewer.

Labour will thus need to reconsider its strategy of relying so heavily on transferring money to poor families in order to cut child poverty. This will require a rethink about why Britain has one of the highest child-poverty rates among developed countries. One reason is that low-paid work is more widespread. But the main cause is that so many parents are not working, says Peter Whiteford of the OECD.

Britain's employment record is better than most. But the labour market is polarised between “work-rich” and “work-poor” households, which particularly affects families. Jobless couples with children are more common than in many other advanced countries. More important, lone parents without jobs make up a bigger share of families. In 2000 they were 7.3% of all households with children, three times the average among 24 countries in the OECD (see chart).

More recent British figures highlight how crucial joblessness is in determining child poverty. In 2004-05, lone parents without work were raising 13% of all children but 31% of poor children. Jobless couples were bringing up 6% of all children but 19% of poor children. Together, the two groups accounted for only a fifth of all children but a half of poor ones.



What this suggests is that the priority should now be to get poor jobless parents back to work. The government has been trying to encourage this by providing extra financial support for working parents. Such help is now among the most generous for low-paid employees in the OECD.

These financial incentives appear to be having some success. The lone-parent employment rate, for example, has risen quite sharply over the past five years. Steep increases in the minimum wage are making work more worthwhile, although there is increasing worry that they may also raise unemployment.

What is crucial now, says Mr Whiteford, is for the state to exert more pressure on lone parents to work while continuing to help them with child care. Britain is unusual in not requiring single parents to look for jobs until their youngest child is 16. Australia, which also has a high proportion of lone parents who are not working, has a similar rule. In most other countries in the OECD, by contrast, single parents have to seek employment much sooner. In July, Australia will change its rule and make new lone parents look for work once their youngest child is six.

Such a reform will seem harsh to many of Labour's supporters. But the government has invested political capital in its campaign to end child poverty and it will soon have to take difficult decisions. This may be a time for some tough love.

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Poverty line

Head count

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The devil in the details

HOW many children are poor? Working it out entails four main steps. First, net household income is calculated by deducting direct taxes, such as income tax, from earnings, benefits and tax credits. Second, net income is "equivalised" to put households, which vary in size and composition and by age of children, on a common footing that is expressed in terms of a childless couple. A two-parent family with two children aged 13 and 14, for example, needs 54% more income than a childless couple in order to have the same standard of living.

The third step is to calculate the median household annual income, which divides the whole population, when ranked by equivalised income, into two halves. In 2004-05 this was £18,148 ($33,539) for a childless couple, but £27,948 of actual income for the two-parent family with children aged 13 and 14. Finally, the income at the poverty line—60% of the median—is worked out. In equivalised income it was £10,889 in 2004-05, the same as £16,769 of actual income for the two-parent family with children of 13 and 14.

The number of poor children varies a lot according to where precisely the poverty line is drawn. On the usual definition, 24% of children were poor in 1998-99. But if the poverty line were set at 50% rather than 60% of median income, the child-poverty rate would have been 13%.

Child poverty can be measured before or after housing costs. The government used both approaches to assess its progress towards the milestone for 2004-05. From now on it will monitor its performance on the basis of poverty before housing costs. This is the international standard but it also produces a lower figure. The shift should make it easier to hit the target for 2010-11 even though new scales for equivalising income will nudge up the number of poor children before housing costs.

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Community relations

Who speaks for British Muslims?

Jun 15th 2006
From The Economist print edition

Not everyone who claims to

“I THOUGHT one by one they're going to kill us. At that time I thought I was going to die.” So Abdul Kahar describes his shooting by police on June 2nd as they raided his house in Forest Gate, east London, looking for a chemical device they never found. He and his brother, Abul Koyair, were arrested and then released on June 9th. The police apologised five days later for “any hurt” they had caused.

Reuters

Just one voice among many

Soon after the raid Muslim groups started to jostle for attention. First out of the starting blocks was the Muslim Council of Britain (MCB), which represents around 400 Muslim organisations. Its new head, the moderate Muhammad Abdul Bari, visited Forest Gate to “listen to concerns amongst the Muslim community”.

Next came the Muslim Association of Britain (MAB), an MCB affiliate whose more radical members favoured a different candidate in the council's leadership contest. The MAB is ideologically close to the Cairo-based Muslim Brotherhood, with which Palestine's Hamas government is aligned. The MAB expressed “sadness and horror” at the police action in Forest Gate. Another group, the Muslim Public Affairs Committee, then called on “sleeping Muslims” to rise up against “repression”.

In the end, a demonstration outside the police station in Forest Gate on June 9th by yet another group, an offshoot of a banned extremist outfit, Al-Muhajiroun, attracted just tens of people at a time when thousands of Muslims were coming out of Friday prayers. Residents were annoyed by outsiders interfering—and, like many other Muslims, now question whether any national organisation, whether moderate or extreme, has the right to speak for them.

Many still see the MCB as the main voice of most of Britain's 2m Muslims and as their main interlocutor with the government. Inayat Bunglawala, the council's spokesman, insists that his group includes all forms of Islam.

Yet many of the roughly 1,100 mosques favoured by Britain's Pakistanis have joined a rival outfit that was formed last year, the British Muslim Forum (BMF). Its members claim that the MCB is too influenced by Saudi Arabia's austere form of Islam, which frowns on the mystical Sufi practices popular in many Pakistani mosques. Khurshid Ahmed, the chairman of the BMF, says that it represents far more mosques

than the MCB now. And many Muslims want a more liberal association, he says. He recently appointed a female chief executive, which dismayed conservatives. The BMF works with Jewish organisations and, unlike the MCB, attended the Holocaust Memorial Day in January.

The government, too, seems to have lost confidence in the MCB since the London bombings—it thinks the organisation should have done more to thwart radicals. A single phone call used to suffice when Downing Street wanted to test the Muslim mood; now the government talks to many more groups than it did. The MCB, for its part, is wary that over-cosy ties with officialdom may cost it credibility in its own community. The government's “monologue with the MCB” is over, says Tahir Abbas, of Birmingham University.

Proof came in August 2005, when the government asked four Muslim groups to help with “Preventing Extremism Together”, a programme to root out radicals from Britain's mosques. As well as the MCB, the BMF, the al-Khoei Foundation (which represents Britain's few Shia Muslims) and the MAB are all involved.

The MAB, meanwhile, has undergone an internal split pitting the pious against the political firebrands. Azzam Tamimi, a former member, says that the MAB has become too mystical. His small rival group, the British Muslim Initative, will focus on international issues like Palestine and Iraq.

Back in Forest Gate, a big demonstration is planned for June 18th, with a bewildering variety of local and national groups taking part. Mr Bunglawala says the plethora of groups reminds him of Monty Python's religious spoof, “Life of Brian”, which abounded in crackpot sects.

Others, though, are worried by the splintering process. Mohammed Sajid, of Bradford University, fears that if the MCB and the government draw closer again, radical organisations may reap dividends. In any case, no single group is likely in future to speak for a monolithic “Muslim community”—for no such thing exists.

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London Underground

Mad dogs and Londoners

Jun 15th 2006
From The Economist print edition

How to keep the Tube cool

Get article background

SUNSHINE and hot weather—such as the record-breaking temperatures earlier this month—are usually cause for celebration in cool, cloudy Britain. But among those who take the Tube in London, the cheers are muted. Travelling on the crowded underground railway, which can be stressful at the best of times, is all but intolerable in the summer heat. The press of sweaty bodies inflames tempers. On the worst days, some passengers faint.

Unlike newer underground railways, the Tube is not air-conditioned. Its Victorian designers relied on the trains pushing air around in the tunnels to provide ventilation, an elegant solution that has become less effective as passenger numbers have risen. Geology compounds the problem: London's clay soil is a good insulator, and heat from passengers and trains has warmed it considerably over the years. With passenger traffic expected to rise by 10% by 2016, things are set to get worse.

On some bits of the network, the problem is easily solved. Transport for London (TfL), which runs the Tube, plans to put air cooling on new trains in the shallower parts of the network, where tunnels are roomy and heat can escape easily.

But the deeper the trains go, the harder it is to keep them cool. Tunnels in the deepest lines were kept small to save money. That leaves no room between the trains and the tunnel walls to fit air conditioning. Putting coolers inside the carriages would mean carrying fewer passengers, and—more importantly—the narrow tunnels leave nowhere for the heat to escape to.

Despite the best efforts of the Tube's engineers, no comprehensive solution has ever been found. Attempts to inspire the public have failed too: a £100,000 ($163,000) prize offered in 2003 by Ken Livingstone, London's mayor, went unclaimed. Some of the designs were certainly creative: one Stygian proposal was to half-flood the tunnels and transport passengers by gondola.

In the absence of a single overarching solution, TfL is planning several smaller measures. One idea, suggested by academics at South Bank University, is to use groundwater, 30m litres of which are already pumped out of the network every day. Engineers are testing a system at Victoria station that pipes cold water from the river Tyburn, which runs beneath the station, to heat exchangers between the platforms. The water cools the air, which passing trains then spread through the tunnels. John Missenden, an academic who worked on the project, reckons this could cool carriages by about 6°C. The Tube's Director of Engineering, David Waboso, says that if the system works it could be installed in about 30 more stations.

Options for the rest of the 275 stations in the system are more limited. Drilling new ventilation shafts is possible, but it is an expensive and disruptive answer to a problem that exists for only a few weeks each year. More efficient trains will help by using less power per passenger, and engineers are pondering cooling trains on the bits of the network that are above ground.

Even if all these plans come to fruition, says Mr Waboso, it will be several years before they can be implemented. Until then, passengers have little choice but to follow TfL's apologetic advice and carry a bottle of water. But Tube bosses may be missing a trick. “The water at Victoria is of drinkable quality,” says Mr Missenden. “In theory, TfL could bottle the stuff and sell it.”

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The NHS and IT

A failure to connect

Jun 15th 2006
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The world's biggest civil IT project has not yet convinced Britain's doctors

SINCE April, general practitioners have received 96p every time they use Choose and Book, a controversial electronic system for referring outpatients. The reason? Fed up with the doctors' resistance to newfangled information technology, the National Health Service (NHS) has resorted to bribery. Reviewing the speed with which GPs adapted to their lucrative new contracts in 2003, it concluded that financial incentives were the key.

Choose and Book is one of the most important applications of Connecting for Health (CfH), the government's plan to transform the creaking NHS through an IT revolution. It is essential if the government is to succeed in giving patients more power over when and where they are treated.

But despite the potential gain to patients in terms of speed, convenience and choice, GPs have been reluctant to use the new system. That is partly because it was launched with a clunky interface, which has been much improved since then, but mostly because it involves changing the way the doctors work. Although Choose and Book is now available to all 31,500 GPs, by the end of March it was being used for only 15% of the 9.5m outpatient appointments booked each year.

On June 16th, the National Audit Office (NAO) was due to report on the progress that CfH, the largest civil IT project in the world, has made in the past year. Its verdict is likely to be mixed, though nowhere near as hostile as the endless press diatribe against the project suggests. CfH is accused of being years late, massively over its £6.2 billion budget, responsible for driving its contractors to the wall and incapable of delivering the promised benefits.

The truth is more complex and less depressing. Costs have in fact been fairly well contained. Under the contracts drawn up with the four regionally based consortia responsible for implementation, nearly all the risk has been transferred to the contractors. Accenture, which leads two of the consortia, was recently forced to write down $450m (£244m) because it encountered difficulties. Richard Granger, the chief executive of CfH, complains: “I get accused of both driving contractors into the ground and hosing them with money.”

Costs have risen because CfH is doing more things: a system for transmitting scans and X-rays from one part of the country to another was added, for example, and there are constant demands for more features and functions. But charges that CfH is as much as three times over-budget are based on a misunderstanding. Some of the cost of implementing the ten-year project was always going to be borne by the existing IT budgets of hospitals and primary-care trusts.

Mr Granger says that while some parts of the project, such as the electronic patient record (EPR), are running late, others, including a system for transferring records from one GP to another when a patient moves and an electronic prescription service, are ahead of schedule. The delays to the EPR, however, are not technical. The “enabling infrastructure” is in place, but medical opinion is divided over whether to use it. Hospital doctors want to see everything that might be relevant to treating an emergency admission but GPs fear breaching their patients' confidentiality.

The NAO is likely to reserve its harshest criticism of CfH for what is known as “clinical engagement”. A gulf of mistrust between Mr Granger's team and the GPs threatens the success of the project. Part of the blame lies with CfH for making a poor job of selling itself. But blame attaches to the GPs too. Their status as independent contractors to the NHS too often blinds Britain's doctors to the wider picture.

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Corporate pensions

Filling in

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Company pension funds are being saved from destruction

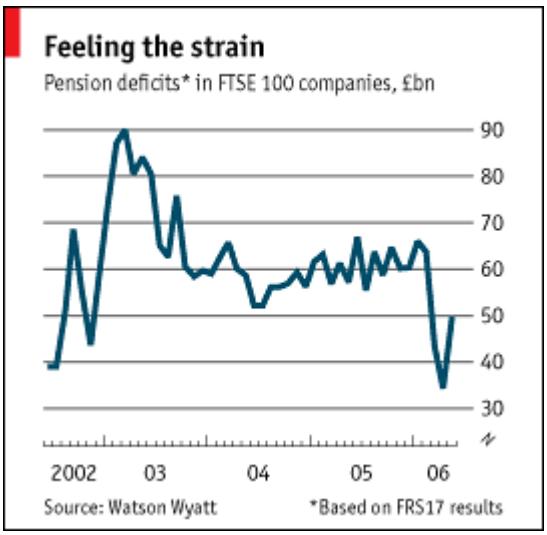
FOR a lesson in how to cut pay and pensions while still appearing magnanimous, look no further than BAE Systems, a British weapons-maker. On June 13th it won wide acclaim for a new pain-sharing plan to close the £3.5 billion gap between what it had promised to pay members of its defined-benefit pension plan and the assets set aside to do so.

To fill the gap, the second-widest among quoted British companies, BAE will put an extra £1.1 billion in cash and property into its fund. It will also increase its pay-related contributions by £642m over 20 years. Employees have accepted pay cuts of £592m over that period and future benefits will be trimmed by £770m.

BAE says that its pension fund plunged into deficit in part because its estimates of retired people's life expectancy leapt by four years between 2002 and 2005. If an employee wants to work beyond 65 and get a bigger pension thereafter, BAE will help him do so. But the company has shifted financial provision for lengthening twilight years to its workers' shoulders.

The rescue comes at a time of renewed concern over Britain's final-salary pension plans. Company schemes traditionally have borne much of the burden of providing for retirement in Britain, allowing the state (and individuals) to do less than in many other countries. But pension-fund balances are influenced not only by assumptions about life expectancy but also by actual investment returns and the current cost of future liabilities. When share prices started their plunge in 2001, the funds of FTSE 100 companies moved from overall surplus to a deficit of some £90 billion in 2003, according to Watson Wyatt, a firm of actuaries (see chart). More benign equity markets helped shrink the figure to about £35 billion in early 2006, but it has risen again, to almost £50 billion.

Three-quarters of all FTSE 100 firms have closed their plans to new members. In December 2005 Rentokil Initial, a business-services firm, became the first to close its scheme to existing staff. Christine Farnish, chief executive of the National Association of Pension Funds, warned last week that pension schemes are becoming untenable and urged the government to let companies cut benefits unilaterally.



Yet both workers and bosses have something to gain from defined-benefit schemes, as BAE's deal shows. Its workers voted overwhelmingly in favour of making sacrifices to save the scheme. That suited the company too. Final-salary plans are a powerful tool for keeping skilled staff, it says. Two-thirds of the companies that have closed plans to new members still see them as a “fundamental component” of their packages, according to Aon, a financial-services firm. More to the point, if a company tries to wind up, or stop paying into, its pension fund, it may have to buy annuities for its pensionable workers, which will prove an expensive escape.

Six months ago it seemed that more companies would follow Rentokil's lead. Now many are seeking to save their pension funds instead. One of them is British Airways, a company with a deficit so large that its chairman, Martin Broughton, describes it as a “pension fund with wings”. The airline is negotiating an

increase in its retirement age and a cap on future payments. Reuters, a worldwide news agency, bailed out its pension plan last month.

FTSE 100 companies paid £10.5 billion into their pension funds in 2004 and probably “considerably more” in 2005, says Bob Scott of Lane Clark & Peacock, an actuarial firm. That amounts to about 10% of the aggregate deficit across all funds in the country, which the Pension Protection Fund, an official insurance scheme, puts at some £100 billion.

Accountants at KPMG reckon that half of these companies could pay off their pension deficits within a year using surplus cash and another fifth could do so within three years. There are pressures for them to do so. The protection fund, for one, charges higher premiums to companies with large pension-fund deficits. New accounting rules have made the deficits more apparent to investors and analysts. Moreover, the pensions regulator is pressing companies to produce plans for closing pension-fund gaps over the next ten years.

Problems may be worse for smaller companies and the subsidiaries of foreign firms, where pension funds usually have a lower ratio of assets to liabilities, says Stephen Yeo of Watson Wyatt. The pensions regulator is gathering data on them now. Its findings may prove sobering.

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Funerals

Pickled

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How changes in the market have revived an ancient Egyptian art

GROWING up in south-east London, Barry Albin Dyer used to play with friends in the funeral parlour that his grandfather owned. When a customer came in, Mr Albin Dyer and his companions would be shooed into the basement, with nothing but coffins and a candle for company. After a while his friends stopped coming round, but Mr Albin Dyer was not put off the family business, which he now runs. “I think”, he says, reflecting on his choice of career, “that the way a society cares for its dead is a sign of how healthy it is.”

His business is typical of the small firms that dominate the funerals market. The biggest single provider is the Co-op movement, which collectively accounts for a quarter of all funerals. Independent funeral directors make up the rest. This fragmentation, plus the prospect of steady revenues from dealing with the remains of the 600,000 people who die in Britain each year, has attracted the attention of private-equity groups. Four years ago Montagu, a private-equity fund, bought a stake in Dignity, which is now Britain's largest publicly quoted funeral business.

Until recently, undertakers were being squeezed by a shift towards cremation from the early 1960s; cremations outnumbered burials by two to one in 1990. This was bad news for funeral directors, who make their margins on elaborate coffins built for eternity, smart cars (among Mr Albin Dyer's limousines is an old Rolls-Royce that once belonged to the Sultan of Brunei as well as a Daimler that ferried the Queen Mother) and graveside gravitas. Yet since then the decline in the proportion of people choosing burials has halted. There are also signs that funerals are becoming more elaborate, and therefore more profitable.

Both the Co-operative Group, which runs the largest of the Co-op funeral businesses, and Dignity report more people requesting horse-drawn hearses. The best explanation for the revival of this Victorian practice seems to be the impact of television: “EastEnders”, a BBC soap, has featured a horse-drawn hearse and so, from time to time, do televised funerals of police officers. But motorcycle-drawn hearses are also in demand, along with jazz bands, woodland burials and even a little non-religious oration, often by a “funeral celebrant” from the Institute of Civil Funerals.

Since few funerals are planned ahead of time (just 6%, according to the Co-op), these personalised touches mean funerals can take longer to arrange. That, plus the scarcity of burial plots in densely populated areas, is producing a longer lead-time between death and burial: in London it can be up to three weeks. Corpses have to be preserved in the meantime. Freezing is one option, but a combination of refrigeration and embalming is more common.

To meet this need, the British Institute of Embalmers, the largest organisation representing the ancient art, now boasts 2,000 members. That includes students, who have to demonstrate their competence on one “straight case” (an ordinary death) and one “post-mortem case” (which involves putting the body back together after a coroner has examined it). Ian Grainger, who runs the Institute, cites a further reason why its members are in demand. With more tourists and migrants coming to Britain, more bodies have to be repatriated. Most airlines, he says, will not carry an unembalmed corpse “because of the danger of leakage in the baggage hold”. Which is perhaps worth pondering while waiting at baggage reclaim.

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Bagehot

The limits of compassionate conservatism

Jun 15th 2006
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Philosophical consistency is not David Cameron's priority

HERE'S a real conundrum. Is David Cameron, for all his touchy-feely Notting Hill modernity, at heart a rather traditional sort of Tory? Or is he a ruthless pragmatist, interested only in what works and willing to jettison any policy or idea that, however dear to his party, may cost it votes?

There was further evidence this week that Mr Cameron will stop at nothing to change the image of his party. Fresh from extolling the sterling qualities of public servants last week, the Tory leader, speaking at a banking-awards ceremony on June 12th, made the extraordinary suggestion that banks might influence the companies to which they lend, urging borrowers to behave with more corporate responsibility and shed their “evil” image.

Meanwhile, Mr Cameron's own efforts to define himself provide few clues as to what he really is. At different times he has described himself as a “liberal Conservative”, “Conservative to the core” and “Blair's true heir”. Most often, when asked to sum up his political creed, he says he is a “modern, compassionate Conservative”—modern because he's open to new ideas, compassionate because he wants to help society's unfortunates and Conservative because he doesn't believe that every problem can or should be solved by state action.

Most people like to think they are open-minded and few would admit to wanting to grind their heels in the faces of the deserving poor. The only remotely distinguishing thing about Mr Cameron's beliefs is his apparent scepticism about the size and role of the state. He comes up with remarks like: “There is such a thing as society [Margaret Thatcher once famously declared that there wasn't]; it's just not the same thing as the state.” But what does he mean by it? In an attempt to provide some philosophical underpinning to Cameronism, Policy Exchange, the Tory leader's favourite think-tank, has produced a booklet by Jesse Norman and Janan Ganesh entitled “Compassionate conservatism: what it is; why we need it”.

Part of the authors' mission is to reclaim the term “compassionate conservatism” from George Bush, who used it as an election catchphrase in 1999. Mr Bush, they argue, was neither compassionate nor conservative: he failed both to direct money where it was most needed and to curb big government. Designed to pander to the evangelical right, the phrase embodied a moralising doctrine that the federal

government had a duty to reverse society's moral decline.

Their main purpose, however, is to show that compassionate conservatism is not an oxymoron. The idea of compassion they promote is neither that of the “enterprise state” (for which read New Labour's “enabling state”), which attempts to tackle poverty through a series of top-down initiatives, nor that of the condescending paternalist. It is, rather, a sense of fellow-feeling, identification and sympathy for others. The authors rhapsodise about the possibility of a “connected society” based on “culture, identity and belonging” and all those “intermediate institutions which link us all together and give fulfilment to our lives”. Hobbes and Burke, the founding fathers of British conservative thought, and their 20th-century successors, Hayek and Oakeshott, are all called to the aid of their party.

It's romantic stuff, but what implications does it have for what a Cameron government would actually do? This is where it gets tricky. Mr Cameron says that he has no intention of dropping the government's ambitious goal to halve child poverty by 2010—an archetypally state-driven target if ever there was one.

The Policy Exchange pair seem to think that compassionate conservatism would result in a “large-scale programme of state decentralisation”. They are keen on strengthening local government and breaking up the monopoly provision of public services. But what is uniquely compassionate-conservative about that? Almost everyone these days favours strengthening Britain's enfeebled local councils, and Tony Blair is opening up the NHS and the schools system to competition from new providers as fast as capacity and funding will allow.

The big idea that most excites Mr Cameron is the expansion of the so-called “third sector”—the fashionable umbrella term for voluntary, not-for-profit and charitable organisations. Mr Cameron has long believed that these have the potential to take over the delivery of many services that are currently provided by the state and that they are especially effective in extending help to the victims of “state failure”.

Instinctively Tory

But the government too has become keen on harnessing the creativity and energies of the third sector, for example in delivering programmes to get people off long-term incapacity benefit. This week it announced that it was setting up an office for the third sector inside the newly created department for social exclusion. Reasonably, Mr Cameron argues that in practice Labour finds it harder than a Conservative like himself to “let go” and trust these organisations to develop and prosper. The Tories are also more likely to ignore the complaints of public-sector unions threatened with competition from the voluntary sector.

It is doubtful, however, if any of this will amount to more than nibbling at the edges of state activity. Although the number of professionally run not-for-profit businesses is growing, the vast majority of social entrepreneurs run tiny operations that cannot scale into anything bigger. The third sector deserves every encouragement but, as Mr Cameron is smart enough to recognise, the idea that it can soon replace large swathes of what the state currently does is optimistic.

As a slogan, “modern, compassionate conservatism” may say something important about Mr Cameron's instincts. Whether those instincts are any guide to what he is prepared to do and say to win power is another matter.

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The physical internet

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Like information on the internet, goods are moving around the world with ever greater efficiency. But Paul Markillie spots dangers lurking in modern supply chains

Corbis

LOUISVILLE, Kentucky, 2am. Roaring thrust-reversers rapidly slow the giant MD-11 jet as it touches down on the runway before turning to taxi towards a sprawling floodlit building. Seconds after it has pulled up at the ramp, large doors on the fuselage swing open and people scurry around with equipment. But they are not about to unload hundreds of passengers: instead, the aircraft carries stacks of air-freight containers stuffed with parcels and documents. Soon they will be emptied to join the 300,000 packages that are sorted every hour at the UPS Worldport.

Every package is automatically photographed, measured and weighed and has the information on its super-barcode analysed by computers to determine its trajectory along some of the 17,000 conveyor belts. This requires awesome computing power: more data are processed here every 30 minutes than in an entire day of trading on the New York Stock Exchange. Eventually the packages slide down a chute to be placed into a bag or an air-freight container. And before dawn they are off again to complete their journey in another aircraft or in one of a fleet of waiting trucks.

A few hundred miles to the south-west, in Memphis, Tennessee, more landing lights line up across the night sky. This is FedEx's global hub, and for the next few hours an aircraft will land here every 90 seconds. Every one of them has the company logo painted on its tail. Tractors towing containers and cargo pallets dash everywhere. Documents are automatically sorted in a maze of machines. In one giant building, known as the “matrix”, packages zoom around on 300 miles of conveyor belts. Before dawn, all these packages too will have departed again.

As the night continues to travel west, similar scenes unfold at airports in Manila, Taipei, Hong Kong, Mumbai, Guangzhou, Dubai, Cologne, Paris and Anchorage. The goods moving through these air-cargo hubs range from items bought on eBay to vehicle parts, fresh flowers, books, computers, transplant tissue—just about anything imaginable. Even live whales have been “FedExed”. And when the night reaches America again, the landing lights once more appear in the sky over Louisville and Memphis.

21st-century clippers

Frederick Smith, FedEx's chief executive, compares his company's jets to clippers, the sailing ships that once carried cargoes on the trade winds. Mr Smith pioneered the air-express business in the early 1970s by delivering a few hundred parcels overnight to a handful of American cities using Falcon aircraft the size of an executive jet. At Memphis airport, the parcels were sorted on a table. Many of his contemporaries thought he was mad: who would pay to send packages by air? He almost went bust. But now FedEx has ordered a fleet of double-deck Airbus A380s to help cope with demand. Rival UPS has also placed orders for the huge new Airbus. Neither company wants any seats inside, just space for lots of cargo. If they were passenger airlines, UPS and FedEx would now rank among the world's biggest carriers.

In an effort to rebrand itself, UPS is painting the phrase “Synchronising the World of Commerce” on its 270-plus aircraft and 90,000-plus vehicles, including its distinctive dark brown delivery trucks. It may not exactly trip off the tongue, but it is an apt description of a business that has grown far beyond simply delivering things. Nowadays firms ranging from trucking companies to freight forwarders, shipping lines, air-cargo carriers and post offices are more likely to use the word “logistics” to describe what they do.

Logistics is a military term. As generals know, wars can be won or lost by it even before they are fought. Now companies are having to become more involved in planning their own logistics. Under relentless pressure to reduce costs and increase sales around the world, firms are outsourcing operations to subcontractors who can do them better and more cheaply, and moving more of their production and services to lower-cost countries.

Globalisation requires greatly increased co-ordination of transport by road, rail, sea, air and now also by an entirely new route to market: the internet. This makes logistics vastly more complex. The job of ensuring that all these things work together is known as supply-chain management. Thomas Freese, an American consultant in this business, explains: “Supply-chain management is an evolution of logistics. Logistics tends to be tactical, supply-chain management is strategic.”

Supply chains are becoming not only longer but also more enveloping. Supply-chain management these days can include anything from buying raw materials to managing suppliers, warehousing, operating transport fleets, taking orders, collecting payments, repairing products and even answering the telephone at call-centres. Companies are also outsourcing supply-chain services.

Yet supply-chain management is not just about wringing costs out of a business. It can also be used to increase revenue and boost profits without necessarily lowering costs. Indeed, some companies have re-engineered their supply chains to gain a huge competitive advantage. What has put Wal-Mart ahead of Sears in retailing, Dell in front of Hewlett-Packard in the personal-computer business and Zara ahead of Marks & Spencer in fashion? The market leaders all have supply chains that are more responsive to customer demand, according to Yossi Sheffi, director of the Massachusetts Institute of Technology's Centre for Transportation and Logistics.

Things like transport, purchasing and warehousing used to be considered merely part of the cost of doing business, and were often managed as separate entities. Now they are coming together as a strategic item on the chief executive's agenda. There is a reason for this. “Supply-chain leaders are very aware of how a company runs because they have to deal with all the different components of the operation,” says Rick Blasgen, who used to work for a big American food group and now runs the Council of Supply Chain Management Professionals.

But as this survey will show, supply chains harbour dangers too, and managing risk is becoming a pressing issue. A number of alarm bells have started ringing. Most firms have been organising their logistics to make themselves leaner. Many now carry little or no inventory to save money. Indeed, sometimes their entire inventory consists of what is moving from the factory directly to the consumer in the back of a truck or an aeroplane. If something goes wrong—and it often does—business will quickly grind to a halt.

Experts worry that some companies do not fully understand the risks of operating very lean international supply chains—or that they choose to ignore them because their rivals are forcing the pace, purchasing critical components from a single supplier to increase their buying power. In fact, some firms do not know who is supplying their suppliers—or even where some of their lower-tier suppliers are based.

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Shining examples

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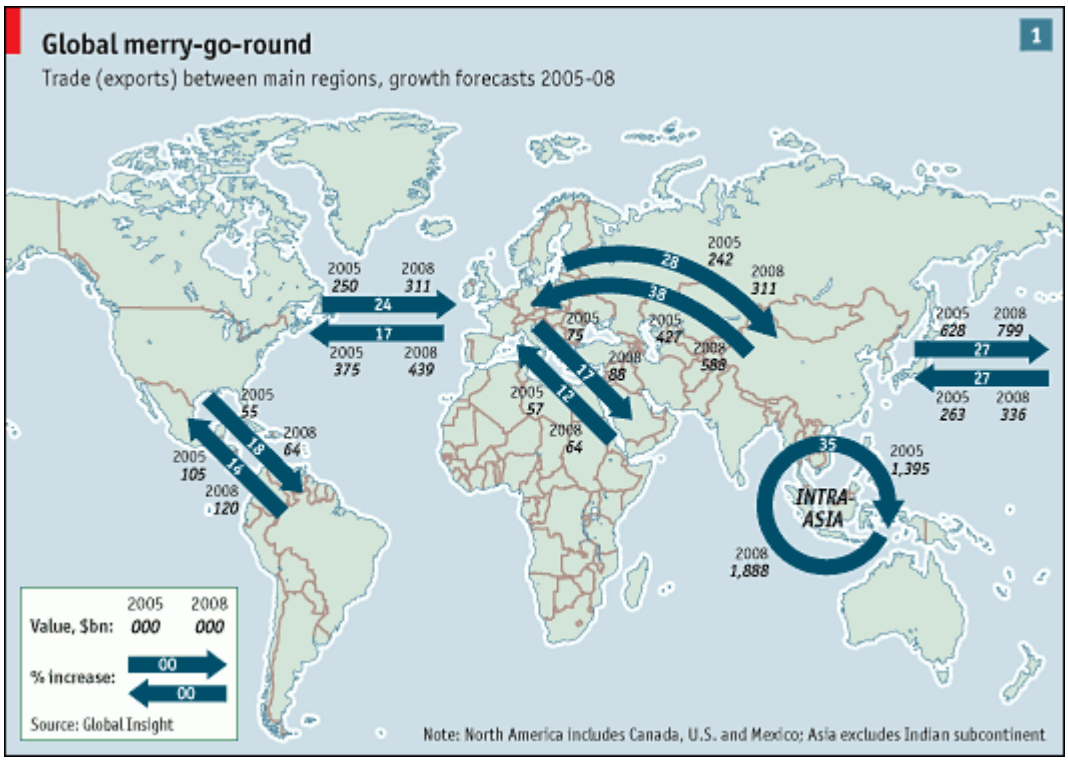
How three large and successful companies are using their supply chains to compete



COMPANIES are now tweaking their logistics to give themselves more flexibility should anything go wrong. For instance, instead of relying entirely on manufacturing in low-cost regions, they may put part of their operation—perhaps a rapid-response warehouse or a second factory—closer to, or even inside, the big consumer markets of America and Europe. This will increase costs, but could prove worthwhile by providing greater responsiveness as well as an insurance against risk. Such moves might even put a modest brake on globalisation, although trade flows—especially to, from and within Asia—are likely to continue to grow strongly (see chart 1).

Most experts rate Dell's supply chain as one of the best, even though the computer company faces increasingly tough competition. Instead of building computers according to a sales forecast and letting other companies sell them, Dell sells directly from its own website and call-centres and then builds to order. That way, it not only cuts distributors and retailers out of its supply chain but also gets paid up front. It orders some of its components only when it has received an order itself.

To succeed against its low-cost rivals, Dell must have a supply chain capable of getting computers to its customers within a few days. The company outsources some operations, such as component production and express shipping, but runs its own assembly lines in America, Ireland, Malaysia, China and Brazil. Last year the company opened its third assembly plant in America, in Winston-Salem, North Carolina. This can make a desktop computer every five seconds. Dell decided to expand in America in order to be close to its customers, but it is still growing in Asia too.

In terms of speed to market, Dell has much in common with Zara, a fast-fashion company that is part of Spain's Inditex group. Fashion is highly perishable, quickly influenced by the latest thing seen on the catwalk or on the back of a celebrity. Zara's designers follow such fashion trends closely. But whereas a

typical clothing company manufacturing in Asia could take six to nine months to get a new design into the shops, Zara completes the process in around five weeks. It buys some garments and material from Asia, often partly finished or undyed, but around half its clothing is manufactured in-house at its base in La Coruña in north-west Spain, or by a cluster of small contractors in the same area. The clothing is delivered by truck to Europe and by air to the stores Zara is now opening in other parts of the world.

AFP

From catwalk to checkout in five weeks

Zara avoids mass production. Although some stock is replenished, its clothing, for both men and women, is deliberately made in small batches. This helps create a scarcity value: better buy now in case it is gone tomorrow. It also keeps shops looking fresh and reduces markdowns. At Zara, the number of items that end up in a sale is about half the industry average.

Behind many successful companies lies a successful supply chain. Indeed, someone who knows about logistics may be running the company. Lee Scott, the chief executive of Wal-Mart, rose through the ranks of the company's transport and logistics divisions. And at Toyota, the pioneer of lean manufacturing, Katsuaki Watanabe, who took over as president of the Japanese car company last year, made his name cutting some $10 billion of costs out of Toyota's supply chain.

But buying things more cheaply from suppliers is not the only way of achieving cost savings. Another tempting economy is to cut down on stocks. The chief reason for holding stocks is to smooth out bumps in the supply chain. Hau Lee, a professor of operations, information and technology at Stanford University, points to one of the biggest sources of inefficiency in logistics. He calls it the “bull-whip effect”, after the way the amplitude of a whiplash increases down the length of the whip when it is cracked.

Procter & Gamble (P&G), a giant consumer-goods company, discovered this effect more than a decade ago. The company noticed an odd thing about Pampers, its well-known brand of disposable nappies: although the number of babies and the demand for nappies remained relatively stable, orders for Pampers fluctuated dramatically. This was because information about consumer demand can become increasingly distorted as it moves along the supply chain. For instance, a retailer may see a slight increase in demand for nappies, so he orders more from a wholesaler. The wholesaler then boosts his own sales forecast, causing the manufacturer to scale up production. But when the increase in demand turns out to have been only a blip, the supply chain is left with too much stock and orders are cut back.

A more reliable flow of information can smooth out these fluctuations. One way of achieving this is to integrate supply chains, as P&G has now done with Wal-Mart and other big retailers. The idea is to organise things so that sales information from a store will automatically prompt the level of deliveries needed to keep the shelves stocked.

For a company such as Wal-Mart, with more than 60,000 suppliers in America alone, keeping everyone informed is critical. The company does this through its Retail Link system, which suppliers can tap into over a secure internet connection. They can check stock levels and sales down to the level of individual stores. Wal-Mart may have a brutal reputation for driving down costs, but its investment in information systems has played a large part in building one of the world's most efficient supply chains, capable of

handling more than $300 billion of annual sales.

There is a direct relationship between inventory and information, says Martin Christopher, director of the Centre for Logistics and Supply Chain Management at Britain's Cranfield School of Management. The more information a company has about its suppliers and its customers, the better it is able to plan. A greater understanding of each link in the supply chain can also improve efficiency and reduce risk. This is leading to a much higher level of co-operation, says Patrick Ducasse, global head of the consumer practice at Boston Consulting Group. According to Mr Christopher, in future it will be supply chains that compete with each other, not individual companies.

Members of supply chains invariably do business with one another over the internet. You may not know how to ship a product from, say, Bangladesh to Barbados, but there will be a freight forwarder or express-delivery firm that does. Increasingly services of this kind are available online. Some companies, such as INTTRA and GT Nexus, two American firms, now provide specialist web-based platforms capable of doing much of the work for logistics managers using ocean freight. The internet is ideal for this purpose, says Greg Johnsen, of GT Nexus: “It is global, it is always on and you can get to it from almost anywhere.” His service, which provides on-demand logistics software that links into widely used office applications, now has around 40,000 regular users.

Logistics managers ship their goods through hub-and-spoke systems that resemble those used by the internet, except that they are visible. If you could look inside the big internet exchange points scattered around the world, you would see immense numbers of packets of information, each with an address attached, all being read, redirected and sped on their way, just like their physical equivalents in the cargo hubs at Louisville and Memphis. And just as computer networks are getting faster and more efficient, so too are those for moving goods in the physical world.

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Manufacturing complexity

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From The Economist print edition

As distinctions between ownership and control become blurred, supply chains are getting more twisted

IT COULD happen anywhere in the world, on any production line, but if one of its products or components fails a test, Cisco Systems knows about it. This is because the world's largest maker of the networking equipment that powers the internet has linked up all the test machinery in the factories that make its products, and results are immediately relayed to Cisco's headquarters in San Jose, California. If the company's engineers do not like what they see, they can remotely shut down a production line or distribution centre until the problem is fixed.

The Guardian

Our daily bread

This degree of transparency in a global manufacturing operation is quite remarkable—even more so when you consider that Cisco, which may achieve sales of some $28 billion this year, does not own the vast majority of factories that make its products. The company believes that outsourcing has allowed it to grow far more rapidly than if it operated its own assembly plants. But it has had a few problems along the way.

In 2000, Cisco briefly became the world's most valuable company as technology firms' share prices soared to astonishing levels. Some customers were ordering technology products on a hunch that shortages were on the way. But the bubble suddenly burst, and despite its clever manufacturing system Cisco was left heavily overcommitted as some of its customers slashed their spending. In 2001, Cisco reported its first quarterly loss since it went public in 1990 and wrote off $2.2 billion-worth of unsold networking equipment. That was a powerful incentive to improve its supply chain.

This is becoming more complex as Cisco expands into new areas. The big routers and network-switching equipment that make up its core business are custom-built to order. But that does not apply to the consumer products into which Cisco is now venturing. In 2003 the company bought Linksys, which provides wireless networking equipment, much of it for home use. And last year it splashed out $6.9 billion on Scientific-Atlanta, which makes television set-top boxes for video, cable and satellite. As technologies merge, Cisco may make the equipment to broadcast television programmes taken from the internet around people's homes.

Building big internet routers involves some forecasting of future demand, pre-manufacturing certain common parts and rapidly customising the equipment when an order comes in. By contrast, making consumer electronics involves manufacturing lots of standard products that will be sold mostly through retailers.

To keep on top of demand, Cisco has had to do the sort of things that P&G does in supplying supermarkets, avoiding shortages on one hand and too much stock on the other. This means that on the consumer side of its business Cisco is in daily contact with retailers. “What happens in Ohio at Best Buy is going to be quite different at Dixons in Manchester,” says Angel Mendez, head of Cisco's worldwide manufacturing.

Plenty of consumer-electronics companies outsource their production, but Cisco is now having to re-examine whether that is really the best option for its consumer division, because Scientific-Atlanta has done rather well building its own products in its own factories. Mr Mendez is convinced that outsourcing, albeit with strong centralised controls, has given Cisco a huge competitive advantage in its core business, but he is open-minded about what will work best on the consumer side. “The one-size-fits-all solution may or may not be right,” he says. “What does matter is having an agile, adaptable and speedy supply chain.” For Cisco, that means it will have to find a system that can cope with a spectrum of products ranging from $99 consumer items to $1m-plus purpose-built router systems. The answer may be to set up completely different supply chains with some common features, such as combined component-purchasing.

Doing it their way

It is not unusual to find different outsourcing strategies among successful companies in the same industry. Apple, for instance, designs its hugely popular iPod but outsources the supply of the components and the assembly to other companies, many of them in Taiwan and China. By contrast, South Korea's Samsung Electronics is highly integrated, even making its own chips and liquid-crystal displays.

In the electronics business, there are two sorts of contract manufacturer building products to be sold under the brand name of an “original-equipment manufacturer” (OEM), the industry's odd name for a company that outsources its production. The first kind are “original-design manufacturers”, who use their own designs and intellectual property to produce for OEMs. These companies tend to be specialised and design things from the ground up. Most began by making circuit boards but have progressed to designing and producing complete products, such as laptop computers, digital music players and printers. Many are based in Taiwan.

The second kind are providers of electronic manufacturing services (EMS), which make products to the design and specification of an OEM. Increasingly these companies offer a broader range of services, such as helping with the design so that products are easier to make. Such firms include Flextronics, based in Singapore, Solectron and Sanmina-SCI, both with headquarters in Silicon Valley, and Celestica, based in Canada. They all operate factories around the world. Contract manufacturers do not like to disclose whom they are working for, but their clients include IBM, Microsoft, Dell, Nortel, Xerox, Sony-Ericsson, Cisco, Sun Microsystems and Hewlett-Packard.

“It's much more of a supply-chain play now,” says Tom Wright, who is in charge of worldwide logistics for Flextronics. The firm has factories in more than 30 countries around the world, most of them in low-cost regions such as Asia, eastern Europe and Latin America. Companies are constantly asking their suppliers to become “quicker, cheaper and more responsive”, says Mr Wright. “Where it gets massively complicated is the physical movement of all these materials.” That complexity has increased enormously in the past five years, with so much manufacturing moving to China, India and other Asian countries.

Which companies come out on top will depend crucially on the integration of supply-chain information systems, Mr Wright believes. He, too, doubts that there will be a single solution. Flextronics has organised itself into different divisions to handle its $15 billion-plus sales of mobile phones, computers, networking equipment, digital cameras, printers, medical devices, car components and many other products.

One of the problems companies face is that different products may need to move along their supply chains at different speeds. A supermarket, for instance, needs regular supplies of perishable products such as bread, eggs and milk, although customers coming in to buy them will also occasionally buy slower-moving items such as shoe polish or light bulbs. A supplier cannot afford to ignore either. If people cannot find what they are looking for, they may go elsewhere. “Being in stock is one of the most important measures supermarkets look at,” says Sam Israelit, an expert in retail logistics for Bain & Company, a firm of management consultants.

Companies need to offer different service levels for different products, says Mr Israelit. The idea is never to be out of stock of high-velocity items, which tend to be the most profitable. On lower-velocity items, there is slightly more room for error. But demand will also vary by location and season. One supermarket may sell lots of ethnic food because of local demographics, whereas another may get runs on things like barbecue sauce and charcoal when the sun comes out. According to Mr Israelit, “it adds enormous complexity to the planning process.” Few firms will have the clout to build an organisation capable of handling all of these things, so they will outsource their logistics to specialists.

Even P&G, which is one of the world's largest consumer-goods companies, outsources parts of its supply chain, such as trucking operations. The company talks about two “moments of truth” in retailing. First, is your product on the shelf? Second, when you have persuaded a customer to pick your product, does it deliver what it promised? The first requirement can be met through a collaborative effort between supplier and retailer; the second will depend on a combination of things such as product innovation, marketing, packaging, presentation and pricing.

Collaboration in the supply chain improves visibility, says Chris Poole, P&G's director of outbound logistics in western Europe. He calls it “joint value creation”. At a practical level it means that by sharing more sales information, a supermarket planning a special promotion, for instance, can be reasonably sure that a supplier will be able to deliver the necessary goods. At the same time the supplier will be better placed to increase production. With better information, both the retailer and the supplier can afford to carry less stock. “Supply chains are becoming leaner, but paradoxically they can also become more agile,” adds Mr Poole.

There are various ways to streamline the process, he says. One way of reducing costly handling is to put items into “shelf-ready packaging” so they do not need to be unpacked from a box and placed on a shelf individually. In Europe, P&G uses a three-tier logistics system to schedule deliveries of fast- and slow-selling goods, bulky and small items in the most efficient way. The idea is that every shop gets what it wants when it needs it and lorries travel as full as possible. When the load is too small to justify a truck, it is sometimes sent by courier. And thanks to satellite-tracking gear on vehicles, supermarkets can be alerted when a truck is about to arrive so they can prepare for unloading.

Individually these are small things, but taken together they can make a huge difference. In Europe, P&G uses some 2,000 trucks a day just for outbound deliveries. Excluding small items like cosmetics and fragrances, those trucks between them carry more than 1,800 different products. Ensuring that the supply chain runs like clockwork—and to do it every day, seven days a week—takes an enormous amount of effort.

Jumbo task

Yet some companies' supply chains have to cope with things that are a magnitude bigger still—such as building a jumbo jet. A Boeing 747 contains some 6m parts, all of which have to be ordered, tracked, assembled and often carefully monitored throughout their service life. That adds up to a huge information load even for a single aircraft—and this year Boeing expects to deliver almost 400 new jets.

AP

Where the aerospace giants come together

At Everett, just north of Seattle in Washington state, Boeing manufactures its 767, 777 and giant 747 airliners in the largest factory in the world. The parts that go into each aircraft arrive by road, rail and air from all over the globe. Now Boeing is gearing up to produce a new airliner on the site, and at the same time fundamentally reform its own supply chain.

The company has been steeped in the traditions of engineering, yet members of the team developing the new 787 Dreamliner, due to make its first flight next year, now talk like people working on new consumer products. That is largely because the design of the 787 is heavily influenced by Boeing's customers.

These are a varied bunch. For airlines struggling with high fuel prices, the 787 will offer around 300 seats, but with its sleek, lightweight construction it will give a 20% fuel saving over other aircraft of a similar size. To please passengers, the fuselage is designed to give them more room, the windows will dim electronically, and a new pressurisation system will provide them with healthier cabin air. The owners of the aircraft (who nowadays are mostly groups of investors who lease them to carriers) will want the 787 to have a long and flexible service life. It needs to be easily reconfigured to suit different airlines, thus improving their return on investment.

Boeing began development of the 787 by seeking its suppliers' advice, which is also done by other manufacturers, such as Toyota. “We asked them, how would you do it?” says Steven Schaffer, vice-president of Boeing's “global partners”—a title that reflects the new, more collaborative approach. Boeing has already begun to build aircraft more like cars, with a moving assembly line and a larger proportion of parts being completed as sub-assemblies before final fitting. As a result, the number of individual items that have to come together for final assembly has shrunk to a fifth of what it was a decade ago.

The 787 takes that process further. As much as half of its primary structure, including the fuselage and wings, will be made out of light but enormously strong carbon-fibre composite materials. Much of this will be prefabricated, rather than being riveted together from thousands of aluminium sheets and ribs. Two specially converted 747s with huge bulbous fuselages will be used to fly the composite structures directly to Everett.

Suppliers at more than 130 sites around the world are linked together with Boeing's development teams through regular face-to-face meetings, known as “partner councils”. Urgent items are dealt with by video conferencing. These video links, often over secure internet connections, are becoming a common feature in the offices of suppliers and the companies they work for. They are the modern-day version of engineers gathering around a drawing board to scratch their heads and work out how to make something.

Mr Schaffer says that more sharing of information between Boeing and its suppliers allows everyone in the supply chain to take a longer-term view of how the market for the new aircraft will develop. This should allow suppliers to prepare more effectively for future demand, and Boeing to be ready for possible problems. The aim is to smooth out any potential lumps in the supply chain before they materialise. With a price tag of around $130m for each 787, both Boeing and its partners are understandably keen to get the logistics right.

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Cargo cults

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With more and more stuff being moved around the globe, efficiency is at a premium

THERE are few customers more demanding than Toyota. The challenge that Transport Corporation of India (TCI) has been set is to deliver the parts the Japanese company needs to build cars at a factory near Bangalore. TCI operates some 6,000 trucks, which is a good start. But the obstacles are formidable.

Getty Images

A well-contained revolution

For a start, Toyota wants just-in-time delivery. In the car business that usually involves suppliers delivering to a staging area near the factory, often run by a logistics partner, from where components are taken directly to the production line where they are needed, when they are needed. In Bangalore, Toyota wants those deliveries to take place every two hours—and with a level of reliability in excess of 99%.

But how do you do that when roads are often in poor condition and sometimes choked with traffic, and when crossing from one state to another can involve hours of border queues and miles of red tape? Trucks are lucky to manage an average speed of 30-40km (19-25 miles) an hour. With the most distant supplier more than 2,000km away, some components could take a week to reach the factory, always assuming the drivers and the lorries prove reliable and there are no accidents.

“Toyota taught us how to do it,” says Vineet Agarwal, executive director of TCI. His company set up a joint venture with Mitsui, a Japanese trading group, which acts as Toyota's logistics partner in India. They began with training to ensure that drivers would take care of their loads, moderate their aggressive driving habits and wear seat belts. Sometimes trucks are followed to make sure standards are maintained. This has helped to build a reliable service that meets Toyota's service levels, says Mr Agarwal. It has also cut stocks, saving $100m a year in financing costs.

With more overseas companies investing in India, companies like TCI can expect to be kept busy. It is not just India's business-processing sector that is attracting foreign investment. The country is also enjoying a—less noticed—manufacturing boom, and merchandise exports are growing at a rate of about 25% a year.

TCI reckons that India's third-party logistics market will be worth more than $16 billion this year, and that it will grow at a compound annual rate of 6.5%. As India develops, inevitably its low-cost advantage will diminish. On the other hand, the demands of foreign companies will make local supply chains more efficient, in India as well as in other developing countries such as China. And there is still a lot of scope

for increased efficiency.

Mr Agarwal says the cost of logistics in India represents some 13% of GDP. For China, the Council of Supply Chain Management Professionals puts the figure at around 21% of GDP—a big improvement on 1991, when it was around a quarter. America shows just how much cost can be wrung out of the system: back in 1982, logistics represented 14.5% of America's GDP, but now the share is down to just over 8%. Between then and now, estimates the CSCMP, inventory costs in America have fallen by 60%. Europe is lagging behind America, with logistics costs of 11% of GDP or more.

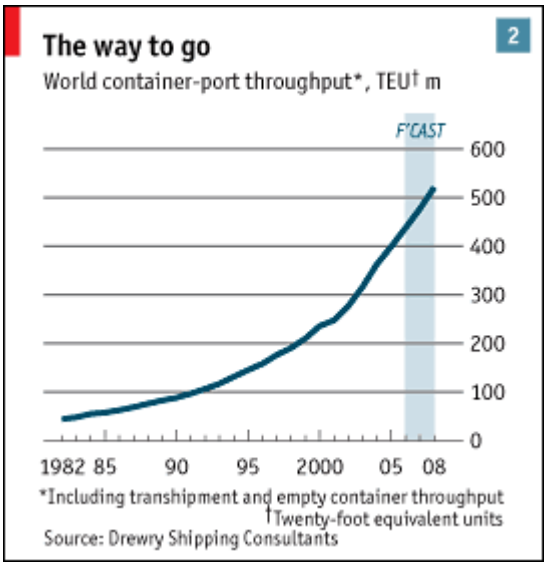
Supply-chain efficiencies can be improved in various ways. One of the most dramatic was discovered 50 years ago when Malcom McLean, a American trucking magnate, reinforced the decks of the Ideal-X, an oil tanker left over from the second world war, and loaded it with 58 large metal boxes containing goods that would normally have travelled as loose cargo. It was this event, says Marc Levinson (a former finance editor of *The Economist*) in his recent book "The Box", which marked the birth of the shipping container.

Boxing clever

The Ideal-X sailed from Newark, New Jersey, to Houston, where after a five-day trip the boxes were unloaded directly onto trucks and hauled to their final destinations. In 1956 the back-breaking business of loading cargo onto a ship cost $5.83 per ton, says Mr Levinson. McLean calculated that loading the Ideal-X cost less than 16 cents a ton. Containerisation dramatically reduced the cost of shipping products from one place to another.

Today most goods and raw materials spend some time in a container as they move around. The container-shipping industry is booming (see chart 2), especially with exports from Asia. Giant container ports such as Hong Kong, Singapore and Los Angeles have flourished thanks to rapid-loading equipment. And container ships are getting bigger. Some now carry around 9,000 containers, and there are plans for giant vessels with double that number, which would require a line of lorries more than 50 miles long to haul away all the containers they could carry.

So why is Kuehne+Nagel (K+N), the world's leader in arranging seaborne cargo, so keen to expand its ground-transport side? The Swiss company developed as a freight forwarder, which means it arranges for other companies' goods to be carried by other companies' ships. It has already become a big air-freight forwarder and also operates road and rail services. Last year it paid €440m ($532m) for Paris-based ACR Logistics in order to increase its presence in contract logistics.



Klaus Herms, K+N's chief executive, says he believes the time is right to develop his company's overland business. That does not mean he wants to own trucks, but rather to buy European companies that do on land what his company already does at sea and in the air. In the next three to five years, Mr Herms hopes to have the whole of Europe covered with a network of trucks working for him.

Trucking has been a highly fragmented and cut-throat business, says Mr Herms. But now the industry is consolidating, thanks to globalisation and the demand for more integrated and specialised services. Increasingly, customers need to use several different modes of transport, which are often handled by the same IT systems. As a freight forwarder, K+N sees its future as offering a broad range of supply-chain services.

Others have the same ambition, including many of the express operators. That does not seem to bother Mr Herms. "They can't jump out of the box," he says. "The box is their prime business." He points out that vast amounts of cargo are not actually carried in an individual box that can be picked up, sorted and hand-delivered. Many goods are carried as bulk loads and on pallets, which can be transported in different ways for maximum efficiency.

Box-bound or not, the three biggest express operators are broadening the range of services they offer.

FedEx began in the air-freight business and grew into ground transport. UPS, which started in 1907 as a messenger and delivery service in Seattle, has expanded into aviation. In May, UPS announced a $1 billion expansion at its Louisville Worldport to boost its sorting capacity by 60%. The company is also investing in lots of warehousing.

DHL, which takes its name from the initials of its three founders' surnames, began delivering documents by air from San Francisco in 1969. It expanded westwards and eventually reached Europe, where it was bought by Germany's Deutsche Post. In December 2005 Deutsche Post bought British-based Exel, a leading logistics-management company, for £3.8 billion ($6.7 billion) and is now integrating Exel with DHL.

FedEx is also offering more services, but is being more selective than its rivals about the areas it wants to expand into, and less convinced about some of the synergies to be reaped. The company is structured so that each of its operating units is free to compete in its own way, even if sometimes they seem to be competing against each other.

In 2000, FedEx started a specialised home-delivery service to meet the growing demand from e-commerce and online sales. The company thinks that residential deliveries are a different sort of business from those made to commercial premises, which are generally manned during office hours. Many people are not at home during the day, so deliveries may need to be made later and alternative collection arrangements offered. Consumers will also expect overnight packages shipped on a Friday to be delivered on a Saturday. For less time-sensitive packages, FedEx also operates a consolidation service that passes packages to America's postal service for final delivery.

That might seem like giving work to a competitor, but FedEx sees it as just another line of business. Even its trucks are starting to compete with its aircraft. Traditionally trucks set off as full as possible to maximise efficiency. But by running trucks to a schedule, which can mean they leave only partly loaded, transport companies can offer guaranteed delivery times. In a lean-manufacturing world such a service could justify higher charges. Like other fast-delivery services, the shipments can be tracked over the internet. The industry calls these operations “less-than-truckload” services. FedEx says its LTL services now span the whole of America. It even offers a money-back guarantee if its trucks fail to turn up at the promised time. For regional deliveries, LTL services can provide a cheaper alternative to sending packages by air.

Having introduced guaranteed on-time delivery services to trucking, could the company expand the idea to ships? Dan Sullivan, a senior executive at FedEx, says the company is currently talking to some operators of fast ships. The ships could, for instance, carry packages already labelled which could bypass some distribution points. “It's all about fast-cycle logistics and taking time out of transit at a reasonable cost and with a high level of service,” Mr Sullivan adds.

FedEx's purchase in 2003 of Kinkos, whose main business was a chain of photocopying centres, has given the company some 1,300 high-street locations, mostly in America. Fedex is now using these to offer additional services. Despite the internet and e-mail, the demand for paper-based communications shows no sign of diminishing. But instead of shipping printed documents by air, FedEx now provides its clients with a remote-printing service. So instead of sending, say, lots of bulky brochures for a sales conference by air, a client could send them electronically to a Kinkos near the venue and pick them up in printed form from there.

FedEx is also using Kinkos as an emergency back-up for companies that supply hospitals with medical devices, such as stents and heart valves. These can be extremely expensive and are sometimes required without notice for unscheduled operations. Such a service could replace what Tom Schmitt, chief executive of FedEx Global Supply Chain Services, calls “million-dollar cars”. Some of the companies that make these devices, he says, keep their back-up supplies in the boots of their salesmen's cars. Now, if a hospital is in desperate need of a particular device, it may be able to find one at its local Kinkos.

The range of logistics businesses the express operators are moving into is huge. One service offered by UPS's local branches is a drop-off facility for broken Toshiba laptops. Most owners think that when they have told Toshiba about their problem and put their laptop into a UPS box, it is sent to the Japanese company to be repaired and then returned by UPS. But what really happens is that when the laptop arrives at UPS's Louisville hub, it is taken to a vast estate of warehouses near the airport and mended in a repair shop owned and run not by Toshiba but by UPS. The UPS technicians are trained by Toshiba and the warehouse holds Toshiba spare parts. Even the people in the Toshiba call-centre that deal with

inquiries work for UPS. The delivery company has been contracted to provide a complete repair and customer-service operation. And having done this for one company, UPS could capitalise on its investment by providing a similar service for others.

One of the big investments UPS is making at Louisville is the development of a huge logistics centre for health-care companies. Vast racks containing boxes of over-the-counter medicines, medical devices, testing kits, surgical supplies and other goods are held in its buildings, some of which are temperature-controlled. “It's a patient, not a package,” states a large banner in one of the buildings where teams of workers sort through the orders that come in from pharmacies, hospitals and doctors. The required items are retrieved and dispatched from Louisville overnight.

Changing the landscape

Historically, transport technology has always made a physical impact on centres of commerce. In the days when cargo was loaded onto ships mainly by hand, factories would often cluster nearby because transport costs were high and delivery slow. With the arrival of the shipping container, factories were able to move to cheaper locations and away from crowded city ports such as New York City and the London Docks. Container terminals did not have to be so close to large population centres, provided they had plenty of space, railways, good roads and workers prepared to handle containers, which many stevedores in older ports were not.

Something similar is now happening around logistics centres, especially at airports. Companies are moving some or all of their operations to be near such centres because this allows them to process orders late into the day and put their goods on the last flight out, for delivery the following morning. As a result, some surprising businesses are setting up shop near logistics hubs. For instance, even though Louisville is a long way from the sea it is now home to the world's biggest distributor of fresh lobsters (see article).

The idea that if you build a logistics centre companies will come is being taken to extremes in the United Arab Emirates. Dubai is investing heavily in infrastructure and businesses for when its oil starts to run out about a decade from now. When its state-owned port operator, DP World, took over Britain's P&O for $6.8 billion earlier this year, America's Congress was up in arms because the purchase came with the commercial operations of six American ports. DP World decided to sell them. Even so, it still ended up as one of the world's largest port operators, alongside Hutchison of Hong Kong and PSA, Singapore's state-backed port authority.

Now Dubai is building what it describes as the world's first “logistics city”. It will be next door to the new Jebel Ali Airport, which will eventually have six runways with a capacity for 120m passengers a year. One runway will be dedicated to cargo aircraft. The new airport is also adjacent to DP World's giant Jebel Ali Port, now one of the region's busiest container terminals. Will the gamble pay off? Dubai is well placed midway between Europe and the booming markets of Asia. But as the region's own businessmen know to their cost, consolidation in the logistics business is creating formidable competition.

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Just-in-time lobsters

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Winging it to the pot

Alamy

World travellers

FOR someone who enjoys maintaining a saltwater aquarium, Mike Middleton has an interesting job. The former marine looks after two 25,000-gallon saltwater pools for Clearwater, one of the world's biggest seafood companies. But he does it in an unexpected place: not at the company's base on the Atlantic coast in Nova Scotia, Canada, but in a small warehouse far from the sea in Louisville, Kentucky.

Mr Middleton is the operations manager for a distribution centre that every week ships some 30,000 pounds of live lobsters to restaurants and adventurous cooks, not only in America but all over the world. He is based in Louisville because UPS has its giant Worldport hub nearby and can pick up his orders in the evening for delivery the next day.

Lobsters are best cooked just before they are eaten to ensure freshness, taste and texture, so they need to be kept alive—and, as Mr Middleton explains, they can get very stressed if not treated well. Once they have been caught by the fishermen in Nova Scotia that supply Clearwater, they are taken to Louisville by truck, a journey that can last more than 30 hours. There they recover in tanks filled with saltwater made from mixing the necessary ingredients with fresh water. The water is kept clean by being passed through giant versions of the sort of filters and skimmers that keep saltwater aquariums in good shape. When an order comes in, the lobsters are packed in special containers for UPS to deliver.

It is not just the proximity of Worldport that makes the Clearwater operation attractive. When the company used to ship live lobsters from Canada to America in small consignments, it faced a pile of paperwork at the border for each shipment. Bringing in a whole truckload at once saves on red tape. Orders can be met more reliably, so gourmets have a better chance of being able to crack open their favourite delicacy.

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Chain reactions

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Delivery companies are consolidating

“WE ARE competing with giants,” says Fadi Ghandour. The Jordanian businessman has first-hand experience of consolidation in the logistics business. He is chief executive of ARAMEX International, which began life as the Middle East partner of a number of American delivery companies. Partnerships and alliances allow operators to link with others to provide services in places where they have no operations of their own. All went well until 2003, when DHL bought Airborne Express, ARAMEX's chief partner in America. The deal gave DHL a way to compete in the backyard of UPS and FedEx. But for ARAMEX it meant its link to the crucial American market was cut.

Bloomberg News

Chasing the competition

To restore it, Mr Ghandour set out his own strategy of alliances and acquisitions, replicating what his big rivals were doing. ARAMEX now offers a delivery service to more than 190 countries. Last year it was listed on the Dubai stock exchange. The company is continuing to buy local operators, and recent acquisitions include logistics firms in Ireland, Britain and Egypt. “There are always entrepreneurs out there,” says Mr Ghandour. “We are never going to be left without a real partner.”

ARAMEX illustrates how local markets present their own, often unique opportunities for logistics companies. ARAMEX's services range from the secure delivery of credit cards and legal documents to delivering goods and accepting payments for users of souq.com, an Arab version of eBay. The company also offers a “shop and ship” service for people buying things in America, especially online. Although international deliveries have become easy, some American companies and traders on eBay will not ship goods overseas. ARAMEX helps out Middle East shopaholics by providing them with addresses in America to which goods can be shipped. It then couriers the items to the buyers.

Consolidation in the logistics industry also extends to postal services, which face a decline in standard mail as more people pay their bills online and send e-mails instead of letters. Coupled with deregulation and privatisation, this has led some mail firms to move into other areas.

Deutsche Post, which became a listed company in 2000, has been the most active with its purchases of DHL and Exel. Britain's Royal Mail has also done well with its express-package business, Parcelforce International, which has grown outside the regulated postal market. But this year there has been more

deregulation in Britain and now the Royal Mail, which is still state-owned, faces new competitors. One of them is TNT, a big Dutch post and delivery service. In May it bought a courier company to allow it to deliver to about 80% of all addresses in Britain. TNT also recently formed a partnership with Japan Post, the world's second-largest postal operator after America's. Japan Post, too, is being privatised.

The internet has already had a profound effect on the delivery business, not least because it enables customers to track their goods. When parcels are being shipped by an express service they are given a tracking number, and every time the parcel's barcode is scanned at a hub or dispatch point its whereabouts are automatically recorded. Customers can follow the progress of their packages by entering their tracking number. Some systems also allow shippers to see online who has signed for an item, thanks to the digital devices now carried by delivery drivers. A London courier company even offers a service that lets people watch their packages move in real time on a web browser (see box on the next page).

Soon the labels on packages will carry a lot more information. Talk to logistics experts about the future, and they are bound to mention RFID. The acronym stands for radio frequency identification, a technology going back to the second world war. Devices using it were fitted in aircraft to bounce back radio signals, distinguishing friend from foe. Today RFID technology is already commonly used in things like motorway-toll tags and keyless-entry devices. Shrinking these devices down to the size of a barcode has now made it possible to attach them directly to products, carrying a wealth of information about them. Some are already printed as part of a product's label, using electrically conductive ink.

The next big thing

Products fitted with RFID tags could work all kinds of magic. In a supermarket, for instance, they could eliminate the need to unload the trolley and scan its content item by item. Simply pushing the trolley up to a checkout would relay all the product and price information, so supermarkets could automate most of their tills. In a warehouse, an RFID reader would record every item loaded into a truck, and a similar device at the truck's destination would record everything being unloaded.

With the addition of suitable sensors, it would become possible to tell whether a product had been dropped or kept at the wrong temperature. Finding a single product in a mountain of containers would become a simple matter of getting an RFID reader to analyse the contents—without even opening the doors. And combining RFID technology with GPS tracking would mean that nothing need ever get lost in the supply chain again.

But such magic is not yet imminent. Some companies that have carried out trials of RFID tags say that the technology is promising, but it still needs to become cheaper and more reliable in the rough-and-tumble of a commercial environment. Christian Kern, chief technology officer of InfoMedis, a Swiss company, has overseen the successful introduction of RFID tags in libraries, where they keep track of books, and medical clinics, where they identify patients to make sure they are given the right treatments. For many applications, however, he thinks the humble barcode is sufficient. “There will be applications I am not even dreaming of; that is quite possible,” says Mr Kern. “But I don't expect miracles.”

One of the biggest boosts to the adoption of RFID tags has come from Wal-Mart, which in 2004 began testing them in 150 stores around Dallas, Texas. By the end of 2006, the tests will be expanded to some 1,000 stores in America. Wal-Mart has already seen some benefits, including a 16% reduction in out-of-stock items in stores using RFID. Moreover, items with RFID tags were replenished three times faster than non-tagged items.

The technology promises other benefits, too. One is a reduction in inventory “shrinkage”—the industry's polite term for pilfering. There have been some concerns that RFID tags might breach personal privacy, but these are mostly overblown. When a customer buys an item the tag can be removed, just like the anti-theft devices attached to existing products.

If Wal-Mart and other retailers greatly expand their use of RFID tags, the price of each tag will keep falling and mass adoption will move closer. Within 15 years most items in shops will carry RFID tags, predicts Sebastian Taylor, an RFID expert working for IBM. Many high-value goods already carry them. Mr Taylor says the average cost of an RFID tag at present is around 20 cents. Next year he expects it to fall to around ten cents. That may seem a small price to pay to put such a clever device on, say, a television set. But attach them to millions of cans of baked beans, and the cost starts to mount up.

Even with existing technology, the amount of information that a supply chain can provide changes the way in which companies deal with both shipments and inventory. “It has allowed our customers to treat our trucks and planes as a warehouse,” says David Abney, president of UPS International. “They know exactly when they are going to receive their goods and they can make decisions based on this information.”

Managing operations such as replenishing stock or delivering spare parts can be outsourced too. This is an area many logistics firms are keen to expand into. “We want to manage our customers' supply chains,” says Mr Abney. In the past it was only multinational companies that could afford to compete with global supply chains, not just because of the cost and complexity of operating trucks, aircraft and warehouses on different continents but also because of the difficulty of managing all these diverse elements. Yet according to Mr Abney, all that has changed. Even small companies can now afford to operate internationally by contracting out the management of the process.

The logistics business used to be all about the management of transport costs, says John Allan, “but it is now more about the ability to transform the capital nature of the business.” Mr Allan ran Exel, one of the leading logistics companies before it was taken over by Deutsche Post. He has now joined the board of the German company and is chief executive of DHL Logistics. More companies, he reckons, are starting to realise that if they can move goods through a supply chain faster and more efficiently, the effect on their performance can be profound, going well beyond being able to keep stocks low.

But as supply chains become longer and more complex, they are becoming harder to look after. “This reinforces the need to have them professionally managed,” says Mr Allan. He would say that, because that is what he does for a living, but he has a point. The ability to design, engineer and put in place a supply chain is no mean feat, even for a big company. Yet the employees who carry out the operations that make up much of a supply chain's individual components, such as driving trucks, overseeing warehouses or operating fork-lifts, are not always treated as though their jobs are important. Specialist logistics operations are in a better position to look after them by offering more training and better career prospects, and will be able to spread their investment in these things across several clients.

The most critical factor in logistics is people. Companies may deploy lots of powerful technology, but a close examination of successful supply chains shows they also pay a lot of attention to their employees, says John Gattorna of the Centre for Supply Chain Research at Australia's University of Wollongong. In a new book, “Living Supply Chains”, he argues that this interest in people is not confined to what happens in the individual firm, but extends to customers as well. “Most successful companies also understand, almost intuitively, what is happening in their marketplace,” he says.

Supply chains come in a number of different forms, and some companies use more than one for different parts of their business. One chain may run lean to keep inventory costs low, whereas another may be more flexible to enable it to respond to new opportunities as they arise. The important thing, says Mr Gattorna, is that different supply chains within an organisation must work together. These days companies cannot afford to make mistakes with their logistics. When supply chains break, the consequences can quickly become disastrous.

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Delivering the goods

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A courier company goes online

MANY successful businesses have been started by someone exasperated by being given poor service. Tom Allason was convinced he could do better when a courier company failed to deliver tickets for an important tennis match in time for the recipients to attend it. He got together with Jay Bregman, an America friend he met at college in the United States, and in the autumn of 2004 the pair launched eCourier in London.

eCourier

Check out my algorithm

When they took a closer look at the courier industry, they found it had low barriers to entry and was very fragmented. Most companies were small and competed solely on price, which resulted in low levels of service and discouraged investment in new ideas. The way most of these businesses operated was to take an order over the telephone and pass it on to a dispatcher, who then sent a radio message to find a free courier. If a delivery was late, more phone calls and radio messages would be needed to find out where it had got to—and every time that happened, costs would go up.

The idea behind eCourier is to put the whole system online. Bookings are made mostly on the company's website. The customer enters the collection and delivery addresses and the order is automatically relayed to the courier best placed to do the job. Customers can then watch the delivery vehicle's progress on their computer screen as it collects and delivers the goods. Collections and deliveries are confirmed by e-mail. The company's couriers use global-positioning-satellite (GPS) devices and hand-held computers to keep eCourier's computer system updated.

The key to the service is picking the right courier, says Mr Allason. The one whom the GPS system shows to be nearest to the job may not necessarily be the most appropriate. For instance, a courier in London may be only a few hundred yards away from a collection address, but if he is on the other side of the Thames it could take him 15 minutes just to cross the river. Other information, such as traffic problems and the performance of individual couriers, also needs to be taken into account.

This is a mathematical problem, and eCourier spent some time hunting around for someone able to solve it. Eventually it found a team led by Cynthia Barnhard, a logistics expert at America's Massachusetts Institute of Technology, which devised an elaborate algorithm that is now at the heart of eCourier's business, in much the same way that a mathematical formula drives Google's search engine. What Mr Allason particularly likes about his internet-based courier system is that it is easily “scaleable”: more couriers and markets can be added without having to hire many more dispatchers or people to run a call-centre.

“There is no longer any need to pick up a telephone to find out where your package is,” says Mr Allason. “Now you can see where it is.” Some 85% of the company's bookings are made over the internet. Business is growing quickly: whereas in its first month in September 2004 eCourier delivered only 25 items with four couriers, it is now delivering around 15,000 items a month with 90 couriers. Needless to say, Mr Allason now gets all his tickets delivered on time.

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When the chain breaks

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Being too lean and mean is a dangerous thing

IT BEGAN on a stormy evening in New Mexico in March 2000 when a bolt of lightning hit a power line. The temporary loss of electricity knocked out the cooling fans in a furnace at a Philips semiconductor plant in Albuquerque. A fire started, but was put out by staff within minutes. By the time the fire brigade arrived, there was nothing for them to do but inspect the building and fill out a report. The damage seemed to be minor: eight trays of wafers containing the miniature circuitry to make several thousand chips for mobile phones had been destroyed. After a good clean-up, the company expected to resume production within a week.

PA

Buncefield burned, firms faltered

That is what the plant told its two biggest customers, Sweden's Ericsson and Finland's Nokia, who were vying for leadership in the booming mobile-handset market. Nokia's supply-chain managers had realised within two days that there was a problem when their computer systems showed some shipments were being held up. Delays of a few days are not uncommon in manufacturing and a limited number of back-up components are usually held to cope with such eventualities. But whereas Ericsson was content to let the delay take its course, Nokia immediately put the Philips plant on a watchlist to be closely monitored in case things got worse.

They did. Semiconductor fabrication plants have to be kept spotlessly clean, but on the night of the fire, when staff were rushing around and firemen were tramping in and out, smoke and soot had contaminated a much larger area of the plant than had first been thought. Production could be halted for months. By the time the full extent of the disruption became clear, Nokia had already started locking up all the alternative sources for the chips.

That left Ericsson with a serious parts shortage. The company, having decided some time earlier to simplify its supply chain by single-sourcing some of its components, including the Philips chips, had no plan B. This severely limited its ability to launch a new generation of handsets, which in turn contributed to huge losses in the Swedish company's mobile-phone division. In 2001 Ericsson decided to quit making handsets on its own. Instead, it put that part of its business into a joint venture with Sony.

This has become a classic case study for supply-chain experts and risk consultants. The version above is taken from “The Resilient Enterprise” by MIT's Mr Sheffi and “Logistics and Supply Chain Management” by Cranfield's Mr Christopher. It illustrates the value of speed and flexibility in a supply chain. As Mr Sheffi puts it: “Nokia's heightened awareness allowed it to identify the severity of the disruption faster,

leading it to take timely actions and lock up the resources for recovery."

There are two types of risk in a supply chain, external and internal. As in the Ericsson case, they can conspire together to cause a calamity. This seems to be happening more and more often. It is not just that inventory levels are getting leaner, but the range of items that companies are carrying is also growing rapidly, points out Ted Scherck, president of Colography, an Atlanta-based logistics consultancy. Just look around a typical supermarket. Where it once stocked mainly groceries, it now also sells clothing, consumer electronics, home furnishings and many other items.

The many faces of risk

This compounds supply-chain problems. "In many cases shippers have gone too far in implementing the lean supply chain and have found themselves virtually out of business because of a by now annual catastrophic event," says Mr Scherck. As examples, he cites a dock strike in California, a typhoon in Taiwan, a tsunami in Asia and a hurricane in New Orleans. More recently a huge explosion at the Buncefield oil storage terminal in Britain's Hertfordshire caused widespread problems for businesses not just locally but across a large part of England.

In 2003 a number of companies suffered serious disruption because of severe acute respiratory syndrome (SARS). Even though SARS turned out to be not as virulent as influenza, and only 8,000 people got infected, with one in ten dying, it still cost an estimated $60 billion in lost output in South and East Asia. The latest worry is the spread of avian flu. If the virus concerned were to mutate and become infectious for humans, the consequences could be far more devastating.

Sometimes even a political wrangle in Brussels will bring a supply chain to a shuddering halt. Last autumn some 80m items of clothing were impounded at European ports and borders because they exceeded the annual import limits that the European Union and China had agreed on only months earlier. Retailers had ordered their autumn stock well before that agreement was signed, and many were left scrambling to find alternative suppliers. A compromise was reached eventually.

The cost of failure

However, most supply-chain disruptions have internal causes, says Vinod Singhal, a professor of operations management at the Georgia Institute of Technology (see chart 3). His research on the effects of supply-chain failures shows that they can be immensely damaging. This emerged from an investigation into what happens to shareholder value when companies announce supply-chain problems, based on a sample of 800 such announcements big enough to generate news in the financial press. The disruptions ranged from a delay in 2000 of shipments of workstations and servers by Sun Microsystems to a parts shortage at Boeing in 1997 that the company said would delay some deliveries.

Typically a company's share price dropped by around 8% in the first day or two after such an announcement. This is worse than the average stockmarket reaction to other corporate bad news, such as a delay in the launch of a new product (which triggers an average fall of 5%), untoward financial events (an average drop of 3-5%) or IT problems (2%). And the effects can be long-lasting: operating income, return on sales and return on assets are all significantly down in the first and second year after a disruption.

Inside job
3
Cause of supply-chain disruptions*
% of firms replying:
0 5 10 15 20 25 30 35
Internal
None provided
Supplier
Customer
Other
Nature and government
*From a sample of supply-chain disruptions announced between 1989 and 2000
Source: Vinod Singhal, Georgia Institute of Technology and Kevin Hendricks, University of Western Ontario

"It's like having a heart attack," says Mr Singhal. "It takes a long time to recover." And have the dangers increased in recent years? Like other experts, he believes that some companies may be running their supply chains a little too lean: "It's great when it's working, but too much leanness and meanness can actually hurt you."

The financial information analysed for this study came out before the terrorists attacks on America on September 11th 2001 and the subsequent massive tightening of security around the world, so global

supply chains today are subject to many more potential hold-ups. Still, it is impossible for customs officials to search every container, box or package entering every country, so the responsibility for security and import declarations rests with the shipper and the company carrying the goods. In effect, the system works by a process of pre-clearance. The details of everything contained in a shipment now have to be sent ahead electronically, and customs and security officials at ports and cargo hubs divert anything they want to take a closer look at.

Companies that put a lot of effort into ensuring the safety of the goods they are sending, or carrying on behalf of others, are likely to be rewarded by seeing them pass swiftly across borders. Customs clearance is itself a huge business. “Information and technology is the only way to accomplish this,” says Ed Clark, chief executive of FedEx Trade Networks. These systems also need to be able to cope with unplanned events. For instance, if a cargo aircraft has to divert to another airport because of bad weather, centrally held electronic versions of the necessary “paperwork” can be transmitted to a new port of entry.

Sometimes even computer systems will not alert a company to a problem. For instance, Toyota is upgrading its business-interruption planning to a higher level in response to the filing for Chapter 11 bankruptcy protection last year by Collins & Aikman, a big American-based supplier of trim items for cars. The parts company had been supplying Toyota in Europe, which had an inkling that something might be wrong and started to arrange alternative supplies to be on the safe side.

“We realised that through good communication and contacts we had managed to identify a risk in good time and take action,” says Mark Adams, Toyota's European purchasing manager. It was a lesson the company wanted to apply more widely, so it launched a weekly get-together for managers, sometimes by videoconference, to discuss any new rumours and potential risks—and work out a recovery plan just in case.

Toyota builds more than 600,000 cars a year in Europe, where it has some 200 first-tier suppliers operating more than 400 factories. They work with second, third and fourth-tier suppliers, so the overall number grows exponentially the further you go down the chain, where problems can be harder to spot. This means the suppliers themselves have to be involved in the risk-management process.

Mr Adams says a supplier may find it difficult to tell the company that it has a problem. But Toyota emphasises that given the co-operative nature of a supply chain, with early knowledge there is more chance of putting things right. Mr Adams explains that as a first step the company would seek to help its suppliers solve their own problems. “We are hugely more competent at this than we were a year ago,” he adds. And so far, Toyota has been able to act swiftly enough to prevent any supply problems holding up production.

Is a lean, flexible and highly outsourced supply chain like Toyota's any safer than the vertically integrated production methods of old, as practised at Henry Ford's giant River Rouge manufacturing complex near Detroit? At its zenith in the 1920s, ships carrying raw materials such as iron ore and coal—often from Ford-owned operations—would unload directly into the plant. Steel was produced on site, then cast, pressed and machined into all the components needed to assemble a car. The process was inflexible—which is why Ford's cars could be any colour as long as it was black—as well as rather inefficient. Toyota has turned that process on its head, making its manufacturing system far more capable of responding to change. That is one of the best insurance policies a company can have.

Corbis

“You are always looking for flexibility, particularly as you manage risk,” says Cisco's Mr Mendez. Again, transparency is important. “Once you understand where you are, you can begin to design and budget for contingencies,” he adds. The risk-management budget should perhaps be seen as separate from the operating and capital budgets, he suggests, to allow risks and their potential costs to be dealt with more directly.

The limits to leanness

Are competitive pressures pushing companies towards running their logistics operations ever leaner? “They are galloping there,” replies Michael Cherkasky, the boss of the company that owns Marsh, the world's largest insurance and risk specialist. “I don't think many understand the risks that are involved.” He is concerned that companies are outsourcing not only peripheral activities but many core functions too. That makes it difficult to pick up the pieces when things have gone wrong.

Britain's Cranfield University is running a research programme into the fragility of supply chains, prompted by the British government after protests over high fuel costs in 2000. Lorry drivers blockaded fuel-delivery depots, bringing many businesses to a standstill. “I reckon this was the first time the government realised there were such things as supply chains, and just how fragile they had become,” Mr Christopher told a recent conference.

Some people even suggest that supply chains should be regulated, a bit like public utilities, because countries have become so highly dependent on private-sector production infrastructure. Barry Lynn, author of a book on this subject, “End of the Line”, thinks that perhaps companies should be required to limit their outsourcing and use more than one supplier of essential items. In his book, he argues that globalisation and outsourcing provide only a temporary benefit to consumers because the companies that form part of supply chains will buy each other up in pursuit of ever greater efficiency, and thus lose most of their flexibility.

There are signs that some companies are already alert to these concerns and may be planning to reorganise their supply chains to make them safer. That process could speed up if disruptions become more common. Mr Sheffi is in no doubt that the best way to achieve a resilient supply chain is to create flexibility—and that flexible companies are best placed to compete in the marketplace.

“Customers are rethinking their global supply chains for a lot of their products,” says Mr Scherck. For bigger firms, that could mean adopting what he calls the “continental strategy”: having a spread of suppliers in different continents for added flexibility, as Dell and Cisco do. Smaller firms may not be able to achieve a geographical spread. But in any case, companies do not want to go back to carrying lots of inventory in different locations. “So you need to do something in-between,” concludes Mr Scherck. “You will have to carry a little more cost than an absolutely lean model, but you get protection.”

“There are very legitimate, very good business reasons not necessarily to complete and ship from Asia,” says Flextronics's Mr Wright. Companies may consider other options in other parts of the world even though these may look more expensive. “Sometimes you might have to go to a higher cost structure to make your supply chain more robust and reliable,” observes Mr Singhal.

So the limits of globalisation may end up being defined by the management of supply-chain risk. And unfortunately the world is unlikely to become any safer. There will always be natural disasters, as well as corporate mistakes. In order to insulate themselves from the consequences, companies will have to spread their risks more widely. That does not necessarily mean fewer aircraft will be queuing up to land at Louisville and Memphis, or that fewer container ships will set sail from Asia's bustling ports. But it does mean that in future companies may spend rather more to maintain a number of different supply chains, and some of those may be closer to home.

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Internet search engines

The un-Google

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Google dominates the lucrative market for web-search, but its rivals are setting out to change that

“THE Google brand has taken on a life of its own,” concedes Jim Lanzone, the boss of Ask.com, the fourth-largest but fastest-growing search engine, and this simultaneously frustrates and delights him. It frustrates him because people say they “google” things even when they go to Ask or other engines to search the web; because Google is considered, for no good reason (in his opinion), “the safe choice under pressure”; and because many people “don't seem to want choice” and stick to Google out of mere inertia.

But it delights him, because Google, having made many enemies, must now fight many battles; and because Google, perhaps out of hubris, appears to be getting distracted. This month, for instance, Google unveiled a free online spreadsheet program, which, like many Google products, has little to do with web search and is meant to needle Microsoft, the world's largest software company, which has a near-monopoly on spreadsheets through Excel. Google, in other words, has impressive momentum, says Mr Lanzone, but a good martial-artist can use his opponent's momentum to overcome him, so “we're using search aikido.”

In terms of momentum—mass times velocity—Google's lead indeed looks daunting. It has by far the most mass, with an American market share of 43% as of April, which reaches 50% counting AOL, an internet property that uses Google's search technology. This compares with 28% for Yahoo!; 13% for MSN, which belongs to Microsoft; and 6% for Ask, which is owned by IAC/Interactive Corp, a conglomerate of about 60 online media brands. Google also has velocity: its market share grew by 17% in the four quarters to this spring, whereas Yahoo! and MSN both lost share. Only Ask has more velocity—its share grew by 35%—but then again it has little mass.

There are also other, even smaller search engines, such as Clusty.com, a service that displays results in thematic bundles, and SNAP.com, an engine founded by Bill Gross, a pioneer in the industry. But because barriers to entry in the search business are high—the engineering talent is limited and data centres that

can simultaneously support millions of searches are expensive—most analysts think that the four big search engines will stay ahead of the tiny ones. The industry is young and switching-costs for users are low (a click, in effect), so there is still the potential for a change in leadership among these four. The contest is fierce, because search results, which display highly targeted advertisements, are the most lucrative pages on the internet.

Comparing the quality—that is, the relevance—of search results is highly subjective, but for the past six years or so Google has probably proved the best at the job. The stroke of genius of its two founders, Sergey Brin and Larry Page, was the PageRank algorithm, which treated the links to web pages as votes conferring authority, just as the best academic papers tend to get the most citations in other research. Google's problem today, says Chris Sherman, the executive editor of SearchEngineWatch, an online industry newsletter, is that “they regard themselves as the best, and yet they don't really seem to have a clear strategy,” which seems to make them dabble aimlessly.

Yahoo!, the largest internet portal with about 400m users (of its e-mail, instant-messaging, music and other products), has spotted this weakness and come up with a strategy to differentiate its own search engine. Yahoo! has been at this game for only two years—it used to use Google for its search technology, until it realised that this was the most profitable part of the business—but now has hundreds of engineers working on it. In contrast to the quasi-religious faith that Google places in its mathematical algorithms, says Eckart Walther, one of Yahoo!'s search bosses, Yahoo! is “about combining the best of people with the best of technology”.

The idea, Mr Walther says, is to “look not only at links between websites but also links between people” and thus to use “social search” to solve “subjective” queries. Caterina Fake, who came to Yahoo! as the co-founder of FlickR, a popular photo-sharing site it bought last year, gives the example of her own search for a lamp shade. A Google search returned lots of lamp stores, but all in generic styles. A search on Yahoo!'s “MyWeb”, by contrast, took into account the eclectic tastes of her friends and came up with the more fashionable, unconventional lamp shade that she was after.

This approach has potential, but also limits. The user has to be known to Yahoo! (ie, logged in) and the results are best when users do a lot of work—by, for instance, “tagging” things they see on the web with descriptions (“cool lamp shade”) so that online friends can benefit from these trails of “metadata”. But most people don't want surfing the web to feel like work, so the metadata is limited. To Mr Lanzone at Ask, the Yahoo! approach sounds like “a long walk for a short beer.”

So Ask—which used to be called Ask Jeeves but dropped Jeeves, a knowing butler, from its logo in February—is taking a different tack. It has come up with ExpertRank, an algorithm that also ranks web pages by incoming links, but is different from Google's PageRank in that it first groups, or “clusters”, pages and links by theme. So instead of using a web page's overall popularity to calculate its ranking, it finds the pages that are most popular among experts on a particular subject, a method that often returns better results than Google's. Ask also uses these thematic clusters to suggest the best ways to narrow or expand a search, a feature called “zoom” that is very popular.

Chris Sherman of SearchEngineWatch thinks that Ask is as good as Google for general web search—but better than Google for finding online maps and images. Ask, he thinks, is therefore starting to resemble Apple in the computer industry, which has a small but dedicated following of fans who consider the Macintosh operating system superior to the dominant Windows system by Microsoft (a comparison that is sure to make Messrs Brin and Page at Google cringe).

As for Microsoft, it has identified Google as a mortal threat to its business and has launched an all-out effort to catch up in online services in general, and in search in particular. Last winter, it tried to buy itself market share by negotiating with AOL for a merger—or at least an agreement under which AOL would switch from Google's search technology to MSN's; but Google pre-empted Microsoft and itself took a defensive stake in AOL. Microsoft has also hired former rivals who are well respected in the industry, such as Ray Ozzie, an innovator best known for inventing Lotus Notes, a collaboration programme, and Steve Berkowitz, Mr Lanzone's predecessor at Ask, who now oversees the MSN portal. Mr Sherman at SearchEngineWatch says the quality of search results on MSN so far “seems to be all over the map”. But, as he points out, Microsoft has a history of coming late to a market with a mediocre copy-cat product that gradually gets better until it prevails. The search-engine battle is not over yet.

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New media

Blogging off

Jun 15th 2006 | NEW YORK
From The Economist print edition

A pioneering blogger moves on to the next big thing

Scoble branches out

"I LOVE Microsoft and Microsoft did not lose me," protested Robert Scoble, a little too loudly, on his blog last week, in a bid to end feverish speculation in the blogosphere about why, exactly, he had decided to leave Microsoft. The software giant's "technical evangelist", Mr Scoble has become the best-known example of a corporate blogger. On his blog, called Scobleizer, which he started in 2000, he writes about Microsoft's products, and has sometimes criticised them fiercely—thereby both establishing his credibility and, by its willingness to tolerate him, helping to humanise his employer.

As blogging's influence has grown, so has Mr Scoble's—both inside and outside Microsoft. Last year, after he blogged against Microsoft's decision to abandon support for a law prohibiting discrimination against gays, the company's managers backed down. He helped write a book, "Naked Conversations: How Blogs are Changing the Way Businesses Talk With Customers", published in January, that has become essential reading for any boss trying to define a new-media strategy for his business.

So why leave? Mr Scoble has denied several of the theories circulating in the blogosphere, including that he had become fed up with having his expenses challenged or with sharing an office; that Microsoft challenged his views too often; that he had become frustrated; and that the firm had not tried hard enough to keep him. Still, his friend Dave Winer, another blogger, described Microsoft as a "stifling organisation" before observing that "when he finally decided to leave, it's as if a huge weight came off him, and all of a sudden, the old Scoble is back." He views Mr Scoble's departure as evidence that Microsoft has been unable to move with the times: "I'm glad to see my old friend didn't go down with the ship." Another blogger says that his departure heralds the "end of honest blogging".

The real reason may be less sinister—though troubling for the growing number of employers encouraging their employees to blog. Blogging allows staff to build a personal brand separate from that of their firm; if they are good at it, and build up a readership, that brand may be more valuable to them elsewhere. Mr Scoble is off to join PodTech.net, a rising star in video podcasting, which is now far more fashionable than blogging and potentially far more lucrative. It seems that Mr Scoble is most impressed by Rocketboom, one of whose founders, Amanda Congdon, is said to be drawing 300,000 viewers a day to her videoblog, and is about to start charging advertisers $85,000 a week—almost as much, Mr Scoble is

reported as saying, “as I made in an entire year working at Microsoft.”

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Pharmaceuticals

Bayer beware

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Two historic German drugs firms scrap for control of a third

TOGETHER, the three German firms would constitute a €40 billion ($50 billion) pharmaceuticals company with some chance of competing on the world stage against their European rivals, Roche, Novartis, Sanofi-Aventis and GlaxoSmithKline. But squabbles between Bayer in Leverkusen and Merck in Darmstadt over a common target, Schering in Berlin, have simply driven up the cost of Bayer's takeover and given Merck a windfall gain of around €400m.

Was it worth it? Schering (which, like Merck, long ago severed its ties with the American company of the same name) is a leader in oral contraceptives and has strong diagnostics and cancer-treatment divisions, but its development pipeline contains no wonder-drug. It has been seen as potential target for a takeover or break-up for some time.

Bayer thought it had an agreed takeover of Schering in the bag at €86 a share—until last week when it learnt that Merck, which had seen its hostile bid in March spurned by Schering, was in the market furiously buying Schering stock. It was not clear what Merck hoped to gain, but there was a danger that it could block Bayer's takeover, which required 75% of Schering's shares to be tendered by June 14th. Bayer and Schering had forged a deal that would keep job cuts at Schering to a minimum and base the group's joint pharmaceuticals business in Berlin (meaning that the economically troubled capital would contain at least one blue-chip firm).

By May 29th only 18.5% of Schering shares had been tendered into the takeover. Bayer extended its deadline to June 14th, but without raising its offer price. Merck saw that as a chance either to make a windfall or to wrest control of Schering, and started buying shares. On June 9th Bayer spent €3.9 billion in the market to buy 23% of Schering's stock to match Merck's 18.6%. The speculation was that Merck wanted to force concessions out of Bayer, trading control for choice businesses or patents from Bayer or Schering. But Merck was giving nothing away.

This week the spending continued. Merck's stake rose to 21.8%. Bayer felt obliged to go above its €86 offer price. Allianz, which had already pledged its 11% holding, sold it to Bayer outright for €88 a share, raising Bayer's stake to around 36%.

By crossing the 30% threshold Bayer was obliged to make a new offer for Schering at a market price. It also filed a suit against Merck in New York, accusing it of flouting American capital-market rules by not explaining its motive for buying the shares. Very soon, however, Merck's motive became clear: it was prepared to sell its stake to Bayer for €89 a share, the price of Bayer's renewed bid. Bayer now has close to 60% of Schering in its pocket. It has agreed with Merck to discuss “expanding and developing” co-operation and has dropped the case in New York.

Merck is the world's oldest pharmaceuticals company. The Merck family owns 73% of it, and until this year the firm was seen as conservative and typically German. The first surprise was its hostile bid, which was fully supported by the family. The second was its silent assault on the Bayer takeover—behaviour worthy of a “special situations” hedge fund.

The battle would have been less public were it not that all three companies, Bayer, Merck and Schering, are listed on the New York Stock Exchange and had to file details of trading in Schering stock with the Securities & Exchange Commission. Aside from the transfer of resources from Bayer to Merck, there may be one other aggrieved party: Allianz, which sold its shares in good faith to keep an agreed merger on the rails. The sacrifice of one euro per share cost it around €20m.

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Aerospace

Stuck on the runway

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Airbus's jumbo-sized problem threatens the firm's future

AP

THE A380 passenger jet was meant to take Airbus to new heights of success. Instead, the problems experienced by the new super-jumbo are dragging the European consortium down. This week Airbus announced a delay of up to seven months for deliveries of the huge 555-seat airliner, which is set to enter service next year. In response, the value of shares in EADS, Airbus's parent company, fell by 26% on a single day, June 14th, wiping €5.5 billion ($6.9 billion) off the value of the firm.

Airbus's announcement went down particularly badly with the markets because it had already extended its delivery deadline by some six months last year. The firm blamed trouble installing the complicated electrical wiring for the plane's entertainment system. It reckons that the delay will cost it €500m a year in lost profits between 2007 and 2010.

Airbus has staked a great deal on the success of its super-jumbo. But even before the latest hold-up, orders had slowed to a near standstill—159 planes have so far found buyers, well below the number Airbus must sell to offset development costs of around €12 billion. The costs of the latest delay will only add to the number it must sell to break even.

Although demand for the new aircraft has been sluggish, Airbus will almost certainly eventually get enough orders to make its money back. It is the knock-on effects of the race to develop the A380 that may pose the more lasting problem for the company. Airbus's factories are now so overloaded that any airline ordering an A380 today would have to wait at least six years before receiving the aircraft— a delay that is understandably putting off potential customers. And Airbus has expended huge amounts of time, money and engineering resources on just one airliner in one part of the market, while attempting to take on Boeing, its American arch-rival, on a number of other fronts, too.

The good news for both firms is that they are running at full stretch because of an unprecedented demand for new passenger jets. In 2005 they shared orders for over 2,000 new aircraft, a new record and far more than in recent times. But after some years of dominance Airbus has now slipped behind Boeing. The American firm came a close second going by the number of orders in 2005 but crept ahead in terms of value. Boeing is set to win on both counts this year.

The reaction of Singapore Airlines, the first to place a large order for super-jumbos, is a reflection of the crisis facing Airbus. As the European firm's shares tumbled, the Asian carrier ordered 20 of Boeing's new

787 “Dreamliners” with a list price of $4.5 billion. And, like other customers, it will want compensation from Airbus for the tardy delivery of the super-jumbo. Emirates, another big customer for the A380, is also less than delighted.

Countering the threat from Boeing's new model is yet another problem for Airbus. The 787 is made from light and strong composite materials that allow higher cabin pressure and humidity, adding to passengers' comfort. Its width will give more space for seating. At first Airbus sought to compete with Boeing's all-new design using an upgraded version of its successful A330. But the airlines are not happy. They want a redesign that incorporates a wider fuselage, too, which could double the cost of developing the new aeroplane to around $10 billion. Worse still, the radical overhaul will delay deliveries of the A350 by a couple of years, giving the 787 a four-year head start. Boeing is also winning the dogfight between its 777 and the Airbus A340.

Airbus's wary investors may recall what happened to Boeing itself when it last ramped up production—and suffered disastrous glitches that set it back years. Airbus could face similar problems and start the next big aerial clash at a disadvantage. Within ten years both firms must replace their ageing single-aisle workhorses, the A320 and 737. Any difficulties for an overloaded Airbus today could spill over into efforts to take on Boeing on the new battlefront. The A380 could leave a long trail behind it.

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Steel

Arcelor wobbles

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Mittal Steel's chances of taking over Arcelor are improving

AP

Sparks fly in the steel business

FOR the first time since Mittal Steel launched a hostile bid for Arcelor in January, the management of Europe's biggest steelmaker is clearly nervous. The Luxembourg-based company is coming out with ambiguous statements. It is refusing a demand by almost one-third of its investors to have a straightforward vote on a critical decision for the company's future. And it is bombarding investors and analysts with ever bigger documents to try and explain its strategy.

At a five-hour board meeting on June 11th, Arcelor's bosses formally rejected Mittal's €25.8 billion ($32.3 billion) takeover bid and reiterated their determination to merge with Russia's Severstal. But at the same time they mandated themselves to meet with Mittal as soon as possible. Worried about the outcome of an orthodox vote on the planned Severstal merger, the board turned down a request for a majority ballot of those who vote at a shareholder meeting on June 30th. Yet it included a resolution on whether to hold such a vote (a legal requirement in many countries, though not in Luxembourg) into the agenda for the meeting.

The board justified its decisions with some odd arguments. According to Guy Dollé, the chief executive of Arcelor, the alliance with Severstal is of such “importance” that it can be stopped only if at least 50% of the entire shareholder base vote against it. Yet he knows full well that on average only about a third of shareholders turn up at meetings. An even clearer sign of his attitude to shareholders is Mr Dollé's proposal to have a proper majority vote on Severstal at an extraordinary shareholder meeting in late August—long after he is hoping to have concluded the deal with the Russians.

The only effective way for Arcelor shareholders to protest the proposed merger with Severstal is to sell their shares to Mittal by July 5th, when its tender offer expires. Most will probably wait for the outcome of the shareholder meeting on June 30th before deciding whether to sell. If Mittal manages to buy more than 50% of Arcelor shares by the time the tender offer expires, the Severstal deal will fall through. With a €140m “break-up fee” in his pocket, Alexei Mordashov, boss of Severstal, would be crying all the way to the bank.

Arcelor's management seems to sense that the likelihood of investors defecting is increasing. On June

12th the company sent out a 38-page document to highlight the advantages of its proposed marriage with the Russians. It is luring investors with cash through the proposed buy-back of 150m shares for €44 each, a generous price. (Arcelor shares are trading at around €33.) It is praising the “unique combination” of Arcelor's operations in Brazil and Severstal's factories in Russia, which would create the only steel group in the world with production in the two regions, and with the lowest costs. And with Severstal's earnings per tonne for 2005, the profitability of the combined group would be nearly 30% higher than Mittal's, which is more reliant on spot contracts and lower-quality steel.

Lakshmi Mittal, the Indian boss of Mittal, is fighting back with his own set of statistics. On June 13th he said he expected his company's earnings before interest, taxes, depreciation and amortisation, a measure of profitability, to reach $9.9 billion in 2008, an increase by over 70% compared with 2005. He is also planning to invest $3.4 billion in his business between now and 2008. Mr Mittal justifies his predictions with the rosy outlook for the steel industry, which he thinks is supported by strong global growth, especially from developing markets. The proposed Severstal merger is a “reverse takeover by a regional operator,” according to Mr Mittal.

Last week antitrust lawyers filed two sets of documents to get the merger approved by the European Commission in Brussels. Usually, the company that will be in charge when the deal is complete notifies the commission, but Arcelor and Severstal do not seem to agree on this central question. Under the terms of the proposed transaction Arcelor will get a 90% stake in Severstal while Mr Mordashov will own 38% of Arcelor.

As the confusion over the nature of the Severstal deal mounts, members of the political establishment in all countries involved in the deal—Arcelor is the offspring of a merger of steelmakers in France, Spain, and Luxembourg—are starting to distance themselves from it. Whereas many politicians initially backed Mr Dollé in his campaign against Mr Mittal, they are now looking more neutral. Analysts and investors are still taking sides, however. “I think Mittal will succeed,” says Richard Brakenhoff, an analyst at Rabobank in Amsterdam, who thinks that Mr Mittal's bid is much the more attractive. Increasingly, those Arcelor investors who will speak in public about the proposed deals, seem to agree.

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Corporate governance

The shareholders' revolt

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A turning point in relations between company owners and bosses?

SOMETHING strange has been happening this year at company annual meetings in America: shareholders have been voting decisively against the recommendations of managers. Until now, most shareholders have, like so many sheep, routinely voted in accordance with the advice of the people they employ to run the company. This year managers have already been defeated at some 32 companies, including household names such as Boeing, ExxonMobil and General Motors.

This shareholders' revolt has focused entirely on one issue: the method by which members of the board of directors are elected. Shareholder resolutions on other subjects have mostly been defeated, as usual. The successful resolutions called for directors to be elected by majority voting, instead of by the traditional method of “plurality”—which in practice meant that only votes cast in favour were counted, and that a single vote for a candidate would be enough to get him elected.

Several companies, led by Pfizer, a drug giant, saw defeat looming and pre-emptively adopted a formal majority-voting policy that was weaker than in the shareholder resolution. This required any director who failed to secure a majority of votes to tender his resignation to the board, which would then be free to decide whether or not to accept it. Under the shareholder resolution, any candidate failing to secure a majority of the votes cast simply would not be elected. Intriguingly, the shareholder resolution was defeated at four-fifths of the firms that adopted a Pfizer-style majority voting rule, whereas it succeeded nearly nine times out of ten at firms retaining the plurality rule.

Unfortunately for shareholders, their victories may prove illusory, as the successful resolutions were all “precatory”—meaning that they merely advised management on the course of action preferred by shareholders, but did not force managers to do anything. Several resolutions that tried to impose majority voting on firms by changing their bylaws failed this year.

Even so, wise managers should voluntarily adopt majority voting, according to Wachtell, Lipton, Rosen & Katz, a Wall Street law firm that has generally helped managers resist increases in shareholder power but now expects majority voting eventually to “become universal”. It advises that, at the very least, managers should adopt the Pfizer model, if only to avoid becoming the subject of even greater scrutiny from corporate-governance activists. Some firms might choose to go further, as Dell and Intel have done this year, and adopt bylaws requiring majority voting.

Shareholders may have been radicalised by the success last year of a lobbying effort by managers against a proposal from regulators to make it easier for shareholders to put up candidates in board elections. It remains to be seen if they will be back for more in 2007. Certainly, some of the activist shareholders behind this year's resolutions have big plans. Where new voting rules are in place, they plan campaigns to vote out the chairman of the compensation committee at any firm that they think overpays the boss. If the 2006 annual meeting was unpleasant for managers, next year's could be far worse.

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Business in Calabria

Bullets in the post

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Doing business in a lawless part of Italy

SOMETIMES the bullets arrive by post and other times they are left at the door. The *'ndrangheta*, Calabria's home-bred Mafia, widely reckoned more deadly than Sicily's *Cosa Nostra*, is always clear when it sends a message. Often businessmen are the recipients and targets of the action that follows, creating a state of fear that led Pippo Callipo, president of Confindustria Calabria, the regional employers' association, to write to Italy's president a year ago to ask for the army to be sent in.

Mr Callipo heads the fourth generation of his family's tuna-processing business near Pizzo, towards the southern end of Calabria's west coast. With a payroll of 200, the sparkling factory, where around 7,000 tonnes of up-market gourmet tuna are bottled and canned every year, is one of Calabria's biggest private employers. Inevitably, it lies in the *'ndrangheta*'s sights. “Armed guards, licensed by the province's prefect, arrive when work finishes in the evening and patrol until morning,” says Mr Callipo. The guards are needed; mafiosi recently torched a nearby clothing factory, leaving an empty jerrycan to ram home the message that the fire was not accidental.

While the *'ndrangheta* threatens, strikes and keeps business under siege, the state fails in its duty to guarantee the physical security that firms need. The situation is not improving. On June 10th in countryside outside Briatico, a town five miles from Pizzo, killers shot a farmer, setting fire to the car in which they had placed his corpse. The farmer had filed complaints against people who had put the squeeze on him. Alas, most businessmen submit to the *'ndrangheta*'s extortion and others willingly exploit the local situation. “These murky conditions provide cover for dirty business and suit many people,” notes Mr Callipo. His words are echoed by magistrates. “A mafia culture dominates Calabria. The strongest make the rules,” says Stefano Musolino, a prosecutor in Palmi, about 40 miles south of Pizzo.

Yet the law has chalked up some successes. When a large container-transhipment port at Gioia Tauro, about five miles north of Palmi, opened ten years ago, mafiosi demanded protection money from its operators. But the company's managing director notified the prosecutors and investigators taped the criminals when they offered, in return for protection money, to solve every problem—past, present and future. Although the port is still open for business, Mr Callipo suggests that the authorities might place a sign at Calabria's boundary declaring that the region has been “closed by the Mafia”.

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Face value

Blowhard

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Wind power has propelled Tulsi Tanti into the ranks of India's corporate titans

Suzlon Energy Limited

IN INDIA, as elsewhere, “rich lists” ranking the wealth of the truly loaded are devoured with fascination and envy. India's latest have also been greeted with some astonishment. They included some well-known names, of course: Lakshmi Mittal, the Europe-based consolidator-in-chief of the global steel industry; Mukesh and Anil Ambani, feuding barons of the now-divided Reliance kingdom; Azim Premji of Wipro, a big technology and outsourcing firm. But in the rankings of billionaires produced in March by *Forbes*, an American magazine, and in May by the *Sunday Times*, a British newspaper, such stars were joined by an interloper, whose nearly $6 billion-worth of assets by early May made him the seventh-richest Indian: Tulsi who?

Tulsi Tanti enjoyed what can only (with apologies) be described as an enormous windfall last September. That was when he sold a minority of shares in his company, Suzlon Energy, which makes wind turbines, on the stockmarket. He was in the right business—alternative energy—in the right market, at the right time. Of all the infrastructural bottlenecks impeding India's growth, a shortage of electricity may be the most crippling. And in the three years ending in April, India's stockmarket had outperformed the overall emerging-market index by 45%. The issue was 46 times oversubscribed.

Like many of his fellow tycoons, Mr Tanti has seen a big chunk of his paper fortune blown away in recent weeks on a storm-tossed stockmarket. But Suzlon's results for the year that ended in March vindicated some of the optimistic forecasts made for the business. Sales and profits had both doubled, and it had captured more than half of the Indian market, becoming the world's fifth-largest maker of wind-turbine generators. India now has 4,500 megawatts of installed wind generators, accounting for about 3.4% of total electricity-generation capacity. Suzlon has built about one-third of them. Worries that plague the industry elsewhere—about birds, noise and ugliness—have, so far, left India unruffled. Wind farms are even becoming tourist destinations, claims Mr Tanti, though acquiring the land for them is a headache.

His company is only 11 years old. It is now based in the state of Maharashtra, in Pune, a manufacturing hub that, because of its wealth of colleges, has also become a magnet for the information-technology and outsourcing industries. But its origins are in a neighbouring state, Gujarat, where Mr Tanti started in the textiles business. He found prospects stunted, and identified the main difficulty: “the cost and unavailability of power”, which accounts for a particularly high proportion of operating expenses in that

industry. In 1990 he invested in two windmills, saw the potential and became an evangelist for wind power. Having formed Suzlon in 1995, he gradually quit textiles. He now counts 260 mills as customers.

In Pune, too, electricity is in short supply and expensive. Last year, in the sweltering summer months, it was without power for three hours most days. As elsewhere, industrial consumers have paid high tariffs, while, in the countryside, power is subsidised (and, when an election looms, often free). Wind power, as Mr Tanti tells it, is the answer. In India a firm wanting to invest in wind power does not need to build captive windmills. Rather, it can buy a generator to be installed on a shared farm, which delivers electricity to the local state-electricity board. If the buyer delivers to the board enough electricity to cover all his own needs, he is spared scheduled power cuts. Even if it is only part of his electricity needs, he is able to recover the capital cost in four years, and hedge his power costs for 20 (the life of a wind turbine), at a fraction of the normal industrial tariff. “The key driver is the low cost,” says Mr Tanti.

Depreciation costs

Another “key driver” is tax. Rahul Bajaj, chairman of Bajaj Auto, which makes motorbikes and three-wheelers, and is Suzlon's biggest customer, says wind power would not be viable without the tax benefits it brings. Most important is an accelerated depreciation allowance of 80% in the year of installation. That may help explain why Aishwarya Rao, a film star, and Sachin Tendulkar, India's most famous cricketer, have invested in wind power, and why so many turbines are commissioned in March, the last month of the Indian fiscal year. S.K. Sharma, of Pune's income-tax department, says that, in Maharashtra alone, Suzlon had more than 100 buyers last fiscal year whose claims for depreciation should be investigated. He questions whether their turbines had actually supplied power (rather than perform trial runs) by the end of March.

Suzlon is now less vulnerable to a change in the tax rules. Last year only about 8% of its sales (by megawatt) were outside India. Three-quarters of its present order book is international. Part of this is a result of its acquisition in March of Hansen Transmissions, a Belgian maker of wind-turbine gearboxes. This was the second-largest foreign purchase ever made by an Indian firm and part of a strategy of “backward integration” to overcome what Mr Tanti identified as the main bottleneck in the company's growth—the supply of components. Even without Hansen, Mr Tanti says exports would have accounted for 40% of Suzlon's sales. A quarter of its nearly 6,000 staff are based outside India. It is building a rotor-blade factory in Minnesota and has invested $60m in a factory in Tianjin, China.

India, says Mr Tanti, is poised to become a “wind-power export hub”. Some still dismiss the idea that wind power can work commercially as a green pipedream. Government incentives have undoubtedly played a role in developing the industry in India. But, aided by a combination of in-house technology and low costs, Suzlon is well on the way to showing that wind power can indeed be a proper global business.

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Work-life balance

Life beyond pay

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Are you a “binge worker” ? Do you “chunk” your career? Companies are having to find new ways to attract and retain skilled workers

Getty Images

A NEW magazine was published in America this month. *Success* is the resurrection of a title first published in 1897 by Orison Swett Marden, an entrepreneur and author of a series of self-help books, including “Getting the Most Out of Life”. The magazine's publisher, Joseph Guerriero, wants today's *Success* to reflect the contemporary workplace, where, he says, success is measured less by money and titles, and more by what is sweepingly referred to as “work-life balance”. The first issue contains an article about men leaving work to become full-time fathers.

Improving the balance between the working part of the day and the rest of it is a goal of a growing number of workers in rich Western countries. Some are turning away from the ideals of their parents, for whom work always came first; others with scarce skills are demanding more because they know they can get it. Employers, caught between a falling population of workers and tight controls on immigration, are eager to identify extra perks that will lure more “talent” their way. Just now they are focusing on benefits (especially flexible working) that offer employees more than just pay.

Some companies saw the change of mood some time ago. IBM has more than 50 different programmes promoting work-life balance and Bank of America over 30. But plenty of other firms remain unconvinced and many lack the capacity to cater to such ideas even if they wanted to. Helen Murlis, with Hay Group, a human-resources consultancy, sees a widening gap between firms “at the creative end of employment” and those that are not.

The chief component of almost all schemes to promote work-life balance is flexible working. This allows people to escape rigid nine-to-five schedules and work away from a formal office. IBM says that 40% of its employees today work off the company premises. For many businesses, flexible working is a necessity. Globalisation has spread the hours in which workers need to communicate with each other and

increased the call for flexible shifts.

Nella Barkley, an American who advises companies on work-life balance, says that large firms are beginning to understand the value of such schemes, “but only slowly”. For most of them, they still mean little more than child care, health care and flexible working.

Yet some schemes go well beyond these first steps. American Century Investments, an investment manager in Kansas City, pays adoption expenses and the cost of home-fitness equipment for its employees. Rob Marcolina, a gay consultant with Bain & Company based in Los Angeles, was allowed time off to marry his partner in Canada, and another break to look after their daughter when she was born to a surrogate mother. Mr Marcolina, who has an MBA from the high-ranked Kellogg business school, says his employer's understanding makes him want to be “part of Bain for some time”.

Businesses have other good reasons for improving employees' work-life balance. Wegmans Food Markets, a grocery chain based in Rochester, New York, frequently appears near the top of lists of the best employers in America. It has a broad range of flexible-work programmes, which gives it one of the lowest rates of employment turnover in its industry—8% a year for full-time workers, compared with 19% across the industry.

Simple programmes can be surprisingly cost-effective. IBM, for instance, is spending $50m over five years on “dependant-care” facilities for its employees. Although that sounds generous, it is the equivalent of little more than $30 for each IBM employee every year. That is far cheaper than a pay rise and probably a better way to retain talented mothers and fathers. Ernst & Young, a global accounting firm, has a low-cost range of initiatives called “People First”. It provides breaks for people to provide care and has over 2,300 flexi-time employees in the United States. James Freer, a senior executive, says he is “absolutely convinced” the initiatives help produce better financial results.

DeAnne Aguirre, a mother of four and a senior partner in San Francisco with Booz Allen Hamilton (BAH), says “it is easy to make the business case” for work-life balance programmes at the consultancy by looking at attrition rates. BAH calculated that it was investing more than $2m in turning a raw recruit into a partner, an investment it should be reluctant to write off. Corning, an American glass company, reckons that it costs 1.5 times a worker's salary and benefits to replace him. If it can retain just 20 workers a year who would otherwise have left, Corning reckons it would produce annual savings of $2.6m.

The spread of flexible work has come about at least partly as a result of initiatives to keep women workers. Companies have had to offer extended periods of leave for them to look after dependants (young and old), and flexible working in between. At BAH, women partners take an average of eight-and-a-half extended breaks during their careers. Men take an average of one-and-a-half. Ernst & Young, keen to show that part-time workers can also become partners, recently made the first such appointment in Houston, Texas.

Some of these initiatives are spreading even to the citadels of binge working, such as investment banks. Lehman Brothers has just launched a programme called “Encore” which is aimed at easing back into the industry people who have spent time out of it (which still means mostly women). The scheme offers retraining and promises part-time work thereafter.

Business schools are now climbing on the bandwagon, too. In October Tuck School at Dartmouth, New Hampshire, will start a course on returning to corporate life after an extended absence. Called “Back in Business”, the 16-day, $12,000 re-entry programme is open only to students with “work experience in a high-potential career”.

The majority will inevitably be mothers wanting to rejoin the workforce. But fathers are also asking for sabbaticals. Work-life balance “is not just a women's issue” any more, says Ted Childs, who is in charge of workforce diversity at IBM. “Men, too, are very concerned about it.”

The demand is being stoked by the “Generation Y”, the under-28s. They look sceptically at the idea of lifetime employment within a single organisation and they are wary of the commitment they believe too often drove their parents to the divorce courts. Hay's Ms Murlis says that today's business-school graduates are “looking for a workstyle to go with their lifestyle”, not the other way round. They are happy to binge-work for a while, but in return want extended sabbaticals in which to chill out.

Many of the more imaginative schemes come from organisations that are not under pressure to report quarterly to Wall Street. Wegmans and American Century Investments are family-controlled businesses and the big accounting firms and consultancies, such as Ernst & Young, KPMG, Bain and BAH, are partnerships. This allows them to take a longer-term view of growth and costs.

To some extent, the proliferation of work-life-balance schemes is a function of today's labour market. Companies in knowledge-based industries worry about the shortage of skills and how they are going to persuade talented people to work for them. Although white-collar workers are more likely to be laid off nowadays, they are also likely to get rehired. Unemployment among college graduates in America is just over 2%. The same competition for scarce talent is evident in Britain.

Just after the dotcom boom ended in 2000, labour-market conditions were very different. Attrition rates shrank then because staff were afraid to leave. Many were offered unpaid sabbaticals for the sake of the firm's health rather than that of the individual. Such conditions may yet recur.

The European way

Europeans suggest that the reason why so many work-life initiatives come first from America is that American firms have more scope for improvement. Paid holidays there, for instance, are considerably shorter than in Europe. Flexible working and the occasional sabbatical may be the local alternative to Europe's longer annual leave, a one-off levelling of the non-pay elements of remuneration in the face of international competition.

The introduction of flexible working, of itself, gives no guarantee that employees' work-life balance will improve. The same technology that enables them to work flexibly from home or on the road also prevents them from ever leaving their office. There are lots of people who choose to sleep close to their mobile phones and their BlackBerries.

Is the fashion for work-life balance here to stay? Plenty of companies eschew such corporate programmes. Martha Stewart Living Omnimedia recently told employees to leave if they were not prepared to work weekends and long evenings over the coming months for no extra reward. Sylvia Ann Hewlett, president of the Centre for Work-Life Policy in New York, says that many workers still have what she calls “extreme jobs”. Global responsibilities and “always on” communications leave little room for balance.

Charles Handy, the author of several books on the changing nature of work, says that young workers today are increasingly “chunking” their lives, dividing them into discrete bits. These include work, parenting, travelling and doing something completely different. He believes this marks a change in attitude that is slowly filtering down from elite knowledge workers to manufacturing employees.

Heavy lay-offs in the early 1990s, mostly the result of enthusiasm for the ephemeral fad of re-engineering, changed attitudes to work. For many, downsizing sounded the death-knell for having a job for life. In “The New Deal at Work” (Harvard Business School Press), Peter Cappelli, a professor at the Wharton business school, claims that, “while employers have quite clearly broken the old deal and its long-term commitments, they do not control the new deal...it is hard to see what could make employees give that control and responsibility back to the employer.” Young skilled workers increasingly write their own terms of employment. In such a labour market, where short-term contracts are the norm, corporate schemes to improve the balance of employees' lives can become a side-show.

Some go further, arguing that in the not-too-long term, the desire of global firms to entice the West's educated elite may disappear in a flash of enthusiasm for the graduates of India's and China's tertiary-education systems. Even today, less than one in five of the world's university graduates are white men.

However, Liz Ramos, the partner at Bain & Company in charge of human capital, says that though employers are looking to India, it will be a while before India's business schools produce graduates comparable to those from Europe and America. Despite all the political heat it arouses, moving offshore satisfies only a small part of the demand for skilled labour in developed economies.

For some time to come, talented people in the West will demand more from employers, and clever employers will create new gewgaws to entice them to join. Those employers should note that for a growing number of these workers the most appealing gewgaw of all is the freedom to work as and when

they please.

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Global markets

Storm in a T-bond

Jun 15th 2006
From The Economist print edition

America's Treasury market is unsettled by inflation, in another jittery week for the world's investors

THIS has been another fraught week for the world's financial markets. It began with stockmarkets tumbling in Europe, Asia and America. And then, just when those markets seemed to have steadied themselves, America's Treasury-bond market, which had hitherto weathered the storms of the past few weeks remarkably well, took a sudden downward lurch.

The cause of the bond market's sell-off on June 14th was another larger-than-expected rise in American consumer prices. In truth, the surprise was a small one, even a rounding error. The core consumer-price index, which excludes food and energy prices, rose by 0.3% in May. Markets had been hoping for 0.2%. But the figure was enough to convince bond-market investors that the Federal Reserve was sure to raise interest rates for the 17th time running at its next meeting on June 29th, and might go further in August. Yields on two-year Treasury bonds increased to 5.1%, their highest level in more than five-and-a-half years. Ten-year yields also pulled clear of 5%.

Curiously, America's stockmarkets rose after the inflation report, having fallen sharply ahead of it. Investors' concerns had been stoked for a good week or more by a host of central bankers, including Ben Bernanke, the Fed chairman, some of his fellow governors and their foreign counterparts. On June 12th Mervyn King, governor of the Bank of England, warned that price pressures in Britain were building up, largely because of rising import prices.

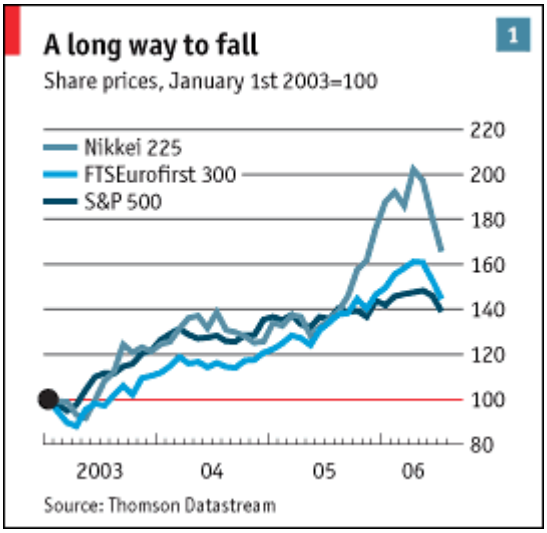
During five weeks of turbulence, however, one of the intriguing anomalies was that the Treasury-bond market had appeared aloof to the inflation fears whipping through global markets. Inflationary expectations, measured by the difference between index-linked and coupon-bearing bonds, fell from mid-May until this week, even after Mr Bernanke issued a stern warning that increases in core inflation were “unwelcome developments”. Gold prices, which are often a hedge against inflation, also fell.

There have been other curiosities about the performance of financial markets that have made it difficult to gauge the seriousness of the sell-off. Stockmarket investors have expressed concern that the Fed, anxious to prove its inflation-fighting credentials, may tighten a notch or two too far, just as its prior moves over the past two years begin to take a toll on economic growth. Already, there are indications that the housing market and consumer spending are cooling.

Yet concerns about a sharp slowdown in growth are not fully reflected in other markets. Corporate bonds, for example, have outperformed shares, giving few indications that economic hardship will raise default rates. Thomson Financial, a data compiler, says that upgrades to corporate-earnings forecasts are still exceeding downgrades in every big stockmarket except Britain's, which hardly indicates pessimism about the world economy. Earnings yields, too, are attractive compared with bond yields, says Peter Oppenheimer, a strategist at Goldman Sachs. “If you look at the numbers, you wonder why people are as worried as they are.”

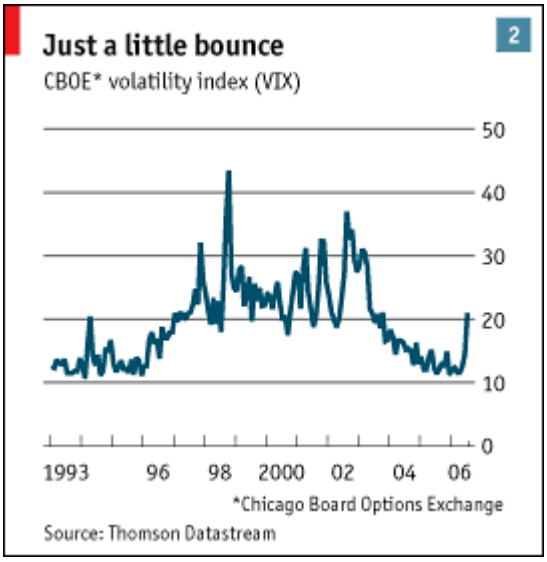
A look at the markets' long-term performance provides further pause for thought. For some investors, the short-term pain is indeed intense. The sufferers include funds that have borrowed a lot and bought shares and commodities shortly before their prices began to tumble. They also include those who sold derivatives offering insurance against falling prices when the sell-off began.

Analysts say the selling of derivatives, as much as any other factor, exacerbated the drop in share prices early this week. On June 13th the Dow Jones Industrial Average gave up its gains for the year, which European markets had done previously, before reviving the next day. In Tokyo the Nikkei sank by 4.1%, its worst one-day decline for two years. Russian, Indian and Turkish stockmarkets tumbled the same day, and the Turkish lira also fell, despite the central bank's best efforts to support the currency. The prices of gold and copper, darlings of the commodities boom, dropped like stones: gold prices suffered their steepest decline in 15 years on June 13th. Even those investors who took what they thought was a safe bet on a falling dollar have been nursing losses.



There is no telling whether the stockmarket slide will continue. But anyone who started investing near the start of the bull run three years ago can still boast a handsome profit (see chart 1). Emerging markets, which have born the brunt of the damage since the selling began on May 10th, remain up more than 125% since the beginning of 2003, according to Morgan Stanley's index. India is up by 167% and Turkey by 212%. Even the Chicago Board Options Exchange's VIX volatility index, which is derived from the prices of options on the S&P 500, is still near the bottom of its long-term range, despite having hit a three-year high this week (see chart 2).

So what else is making investors jumpy, besides growth and inflation? One prominent fear is that central banks are draining liquidity from the financial system. Abundant liquidity has helped support asset prices from Iceland to India, housing to hedge funds, and commodities to consumer credit. According to Joachim Fels, an economist at Morgan Stanley, for the first time since 2000 the growth of GDP in the world's top five economies is outstripping the growth of the money supply, so that less excess liquidity is available “to churn asset prices”. Yet it has not dried up completely. In much of the world, money remains cheap, and plenty is still being recycled through global bond markets.



Ultimately, a greater concern must be that the turmoil eventually spreads beyond the financial markets into the wider economy. One of the main causes for that would be a rise in bond yields that went far enough to make it hard for households and firms to repay their debts. For that reason, investors will be watching the Treasury market like hawks.

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The Bank of Japan

Fukui's fumble

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The future of the central bank's governor is in doubt

THE course of Japanese monetary policy in the next few months, unclear already, just got murkier. On June 13th the governor of the Bank of Japan (BoJ), Toshihiko Fukui, told parliament that he had invested ¥10m ($88,000) in the Murakami Fund, an activist investment fund whose founder, Yoshiaki Murakami, was arrested on June 5th for alleged insider trading. The opposition Democratic Party of Japan called for Mr Fukui's resignation. The government of the ruling Liberal Democratic Party (LDP) quickly closed ranks. The country's media pack is now hounding the central-bank governor as if he were another celebrity rogue. Suddenly, his future is in the court of public opinion.

AFP

The governor explains himself

Mr Fukui's investment was made in 1999. Before parliament again on June 15th, he said that he preferred to call it a “contribution”. That he had invested, or contributed, was no real secret: *The Economist* mentioned it in October last year. Mr Fukui also provided Mr Murakami, a former industry-ministry bureaucrat, with valuable contacts. All this took place when Mr Fukui was still in the private sector. He became governor of the central bank in 2003.

Mr Fukui applied to sell his holding in February, for redemption at the end of June. Amazingly, the governor of the central bank is not obliged to place his investments in a blind trust before taking office. The bank's officials are, however, bound to refrain from any “profit-making” activities if the public might detect in them even a whiff of impropriety. They must make that declaration to their division chief or the compliance committee. The delicate issue here is that the head of compliance is the deputy governor, Mr Fukui's underling. Surely, the bank's policymaking board would have been the better arbiter.

Then there is the sale's timing. In late January came the arrest of Takafumi Horie, the brash head of livedoor, an acquisitive internet group, suspected of financial chicanery. Rumours were rife then that the livedoor investigation might bag Mr Murakami, which has happened. Mr Fukui told parliament that by February he “had begun to have doubts” about Mr Murakami.

At the time of his sale, the governor was contemplating the biggest decision of his career, an end to “quantitative easing”, by which the BoJ had for five years flooded the banking system with excess reserves. The end was announced in early March, and as liquidity was drained, so stockmarkets began to tank. After falling by more than 4% on June 13th, the Nikkei 225 stockmarket index is almost a fifth below its peak for the year, reached in April.

An even bigger decision now follows: when to raise interest rates—which have been at zero for most of the past seven years and which the BoJ left unchanged on June 15th. The stockmarket's fall has greatly complicated matters. Despite denials, the decision is complicated further by Mr Fukui's predicament, with no quick resolution in sight. Even if he survives, a sense will remain that some of the hard-won independence that he gained for the BoJ has been eroded, while the ruling party's politicians will argue that the central bank owes them a favour. The chances that interest rates will increase only after the LDP's race to succeed Mr Koizumi in September have just gone up.

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European insurance

Thirst for growth

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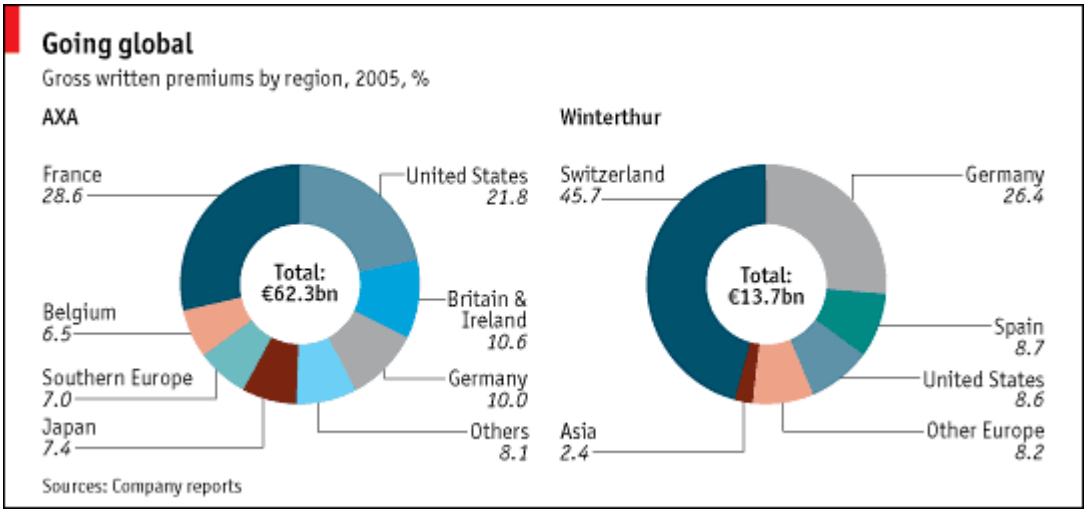

In buying Switzerland's Winterthur, AXA illustrates big European insurers' quest for scale and geographical diversity

HENRI DE CASTRIES, the chief executive of AXA, is not lacking in ambition. Last autumn he unveiled a plan to double the sales and triple the profits of the French insurance and asset-management group by 2012, relying heavily on internal growth. On June 14th Mr de Castries made a foray in another direction, unveiling the purchase of Winterthur, a European insurer, from Credit Suisse for SFr12.3 billion ($10 billion) in cash.

A dashing figure who once worked in the French treasury, Mr de Castries called the purchase of Winterthur “a unique opportunity”. In reality, it was not his first choice. But having previously been rebuffed by Generali, a giant Italian insurer strong in central as well as southern Europe, he chose to look elsewhere. This week's deal lifts AXA nearer to the top of Europe's insurance league, and keeps it in the company of a handful of global insurers distinguished by their size and geographical diversity.

In addition to paying cash for Winterthur, AXA has agreed to refinance SFr1.6 billion of Winterthur's debt, much of it owed to Credit Suisse, which has long been eager to get rid of its mediocre insurance unit. AXA considered buying Winterthur two years ago (for much less money), but those talks came to nothing. After the purchase was revealed this week, it was no surprise that Credit Suisse's share price rose and AXA's fell.

Analysts had mixed views on the deal. Mr de Castries has emphasised the breadth of Winterthur's operations: it serves 13m clients in 17 countries with a mix of life, property and casualty, and pension products. But nearly half its premiums come from Switzerland, a small and mature market, and another quarter from Germany (see chart), where it has 3.3m customers and 1,600 tied agents.

Standard & Poor's, a rating agency, was sceptical. Expressing concern about how easily the French company would absorb its acquisition, it marked its outlook for AXA down to “stable” from “positive”. Rob Jones, an analyst with the agency, considers the Swiss market to be especially difficult. Others were more blunt: “Winterthur is quite a lot of things, but growth it ain't,” said Chris Hitchings, of Keefe Bruyette & Woods, an investment bank. In his view, AXA made the purchase because there were no better deals available.

However, Marc-Philippe Juilliard, of Fitch, another ratings agency, sees decent growth prospects. First, he says, the purchase will increase AXA's market share and distribution network in western Europe. In Germany and Spain, in particular, there is room for a life insurer to grow. Winterthur has good distribution in both.

In addition, Mr Juilliard says, the deal boosts AXA's presence in other markets with longer-term potential. These include Asia and central Europe, where Winterthur has a pension-fund business. AXA already earns more than 7% of its gross premium income in Japan, the world's second-largest insurance market, and Winterthur will give it a bit more. In Hong Kong the combined firm will have more than 10% of the life-insurance market, he says. In China AXA will gain Winterthur's minority stake in Taikang Life, a big insurer, and a licence to write property and casualty contracts.

Most big European insurers are looking farther afield for growth opportunities these days, partly because they are bumping up against each other in the mature markets close to home. Asia is getting particular attention. For instance, Aviva, a British insurer that is one of AXA's main rivals in Europe, had hoped to grab a bigger market share in China by acquiring Prudential, a British rival of similar size, but its bid was unsuccessful.

Capital requirements are also pushing the quest for size and diversity. New rules now being drafted, known as Solvency 2, may favour insurers with more diversified portfolios of risk.

But size is not everything. This week's deal came soon after AXA agreed to sell its reinsurance business to a group of private-equity firms. The sale was seen as a way for AXA to decrease its exposure to volatility, allowing it to concentrate on its core insurance business. The company says it is already more diversified than many rivals, and therefore needs less capital at the group level. Perhaps buying Winterthur offers a bit more insurance on that score.

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Hank Paulson

Riddle solved

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Why it pays to become America's treasury secretary

SIGNING Hank Paulson, chief executive of Goldman Sachs, as America's treasury secretary was a coup for George Bush. The mystery was why Mr Paulson wanted the job. At Goldman, he probably had as much impact on the global economy as he will have in his new job. He certainly had less bureaucracy to put up with and was paid more.

When his appointment was announced, Mr Paulson explained that he was motivated by the “honour” of service. Doubtless he was, but the price of honour looked pretty high. His pay would drop from around $40m a year to $183,500 and he would have to sell his $700m-worth of Goldman shares—meaning, on the face of it, a gigantic bill for capital-gains tax.

Happily, this is not so. It turns out that for someone, like Mr Paulson, who has lots of shares in one company, becoming treasury secretary comes with a whopper of a tax benefit. Possession of a stack of shares in Goldman Sachs is hardly a cause for pity, but even so it is a bit of a financial albatross for the company's chief executive. Selling is next to impossible—not only because of the capital-gains tax, which for Mr Paulson could have exceeded $200m, but also because holding the shares expresses the boss's confidence in the firm better than words ever can. Mr Paulson often made a point of noting that he had kept every share he had ever received.

Yet it is easy to imagine that he may have wanted to diversify his portfolio a little. Profits at Goldman and on Wall Street as a whole are at record levels. In a notoriously cyclical industry, the risk that they might fall is clear. And the stockmarket has been queasy of late.

Becoming treasury secretary, however, allows Mr Paulson to sell his shares without penalty or embarrassment. Sale is required by law: no loss of faith there. And his new job is covered by Section 2634 of the Federal Ethics Laws, a blessing for every plutocrat fortunate enough to secure temporary employment with the executive branch. Under this provision, intended to ensure that taxes do not deter capable people from accepting government jobs, Mr Paulson is able to exchange his holdings in Goldman for various widely diversified investments.

Mr Paulson does not shed his tax obligations entirely—they are carried over to his new investments—but he does not have to realise any gains and can thus postpone payment until he does. He can, in short, diversify without cost, as others who have trod the path from business to Washington, DC, have done before him: an agency called the Office of Government Ethics approves tax-exempt sales by quite a few people each year (but does not disclose the number). At least someone in Washington understands the link between taxes and employment.

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America's unsung accounting boom

Growth in numbers

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A sign that times are good in the overlooked world of accountants

WITH all the grisly headlines about Enron, Refco and so forth, you might suppose that America's accountants were going through hard times. The top firms tend to reinforce this impression by chasing all sorts of business, from risk consulting to merger advice—anything rather than tabulating a company's books. The reason is often thought to be that this is shamefully unglamorous or just too sluggish. In fact, accountants may simply be keeping quiet about a boom.

In all, the revenues of the big accounting firms grew by a healthy 15% last year. And some firms have done much better than this. If the Siegfried Group, of Wilmington, Delaware, were instead known as Siegfried Technologies and worked with silicon transistors, it would be the toast of venture capitalists. Revenues have sextupled in the past two years, to $73m. In 2003 its core accounting business had just 15 clients; last year it had 100; by the end of May it had 155. More than 50 of these are among America's largest companies. Siegfried has even received business from a Big Four accounting firm.

Siegfried's astonishing growth is explained by what it does not do: consulting and auditing, the signature products of the big firms. Siegfried is on the other side of the outsourcing boom: it is an insourcer. Clients call, often in a panic, needing accountants for something a bit different—a merger, or a spin-off, or an unforeseen problem (of which there are lots). Siegfried may send a few accountants; it may send several hundred.

Typically, its accountants stay with a company for six to nine months. Since Siegfried itself does not make recommendations on accounting practice but merely provides labour, it thinks (but is not quite sure) that it is not exposed to the legal risks facing conventional external accountants. In the past the separation between a company and its accountants was seen as a virtue. It still is—but companies increasingly need someone to put their numbers together competently, with the outsiders coming in later to audit the results.

Siegfried stumbled into this niche by chance. In 1988 its founder, Robert Siegfried, left Arthur Young (one of the then Big Eight accounting firms) to set up a small consulting and auditing firm in Wilmington. With hindsight, it would be hard to imagine a more toxic business plan: it was just this sort of model that was blamed for the weak accounting of the late 1990s. Mr Siegfried's good fortune was to have his course changed by a client. In 1995 DuPont, a big chemicals company, sold a large medical imaging unit to Sterling Diagnostics, a smaller company from South Carolina. In a hurry, DuPont needed someone to create a new set of accounts and Sterling needed a far larger financial system. DuPont had no one to spare and Sterling had no one with the expertise. Siegfried's first temporary assignment ended up lasting for two years.

Such needs, it turned out, are not uncommon. After years of cutting staff numbers at headquarters, companies often lack people to throw at a special project and loathe the idea of taking on staff who, if all goes well, will be sacked within a year. By 1998 Siegfried had received assignments from JPMorgan, AstraZeneca and AIG. By 2003 it was opening offices around the country. It now has 27. Consulting and auditing have been dumped: too risky and too distracting.

Mr Siegfried estimates that the business of providing high-end temporary accounting help is already worth $5 billion a year, half going to traditional firms and half to firms like his and big temporary-staff companies such as Manpower, Robert Half and Resource Connections, an accounting specialist. All these firms boast high share valuations, suggesting that their success is not entirely a secret and that more is expected.

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Securitising intellectual property

Intangible opportunities

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Companies are borrowing against their copyrights, trademarks and patents

NOT long ago, the value of companies resided mostly in things you could see and touch. Today it lies increasingly in intangible assets such as the McDonald's name, the patent for Viagra and the rights to Spiderman. Baruch Lev, a finance professor at New York University's Stern School of Business, puts the implied value of intangibles on American companies' balance sheets at about $6 trillion, or two-thirds of the total. Much of this consists of intellectual property, the collective name for copyrights, trademarks and patents. Increasingly, companies and their clever bankers are using these assets to raise cash.

The method of choice is securitisation, the issuing of bonds based on the various revenues thrown off by intellectual property. Late last month Dunkin' Brands, owner of Dunkin' Donuts, a snack-bar chain, raised $1.7 billion by selling bonds backed by, among other things, the royalties it will receive from its franchisees. The three private-equity firms that acquired Dunkin' Brands a few months ago have used the cash to repay the money they borrowed to buy the chain. This is the biggest intellectual-property securitisation by far, says Jordan Yarett of Paul, Weiss, Rifkind, Wharton & Garrison, a law firm that has worked on many such deals.

Securitisations of intellectual property can be based on revenues from copyrights, trademarks (such as logos) or patents. The best-known copyright deal was the issue in 1997 of $55m-worth of “Bowie Bonds” supported by the future sales of music by David Bowie, a British rock star. Bonds based on the films of DreamWorks, Marvel comic books and the stories of John Steinbeck have also been sold. As well as Dunkin' Brands, several restaurant chains and fashion firms have issued bonds backed by logos and brands.

Intellectual-property deals belong to a class known as operating-asset securitisations. These differ from standard securitisations of future revenues, such as bonds backed by the payments on a 30-year mortgage or a car loan, in that the borrower has to make his asset work. If investors are to recoup their money, the assets being securitised must be “actively exploited”, says Mr Yarett: DreamWorks must continue to churn out box-office hits.

The market for such securitisations is still small. Jay Eisbruck, of Moody's, a rating agency, reckons that around $10 billion-worth of bonds are outstanding. But there is “big potential,” he says, pointing out that licensing patented technology generates $100 billion a year and involves thousands of companies.

Raising money this way can make sense not only for clever private-equity firms, but also for companies with low (or no) credit ratings that cannot easily tap the capital markets or with few tangible assets as collateral for bank loans. Some universities have joined in, too. Yale built a new medical complex with some of the roughly $100m it raised securitising patent royalties from Zerit, an anti-HIV drug.

It may be harder for investors to decide whether such deals are worth their while. They are, after all, highly complex and riskier than standard securitisations. The most obvious risk is that the investors cannot be sure that the assets will yield what borrowers promise: technology moves on, fashions change and the demand for sugary snacks may collapse. Valuing intellectual property—an exercise based on forecasting the timing and amount of future cashflows—is more art than science.

So far, says Mr Eisbruck, these bonds have generally matched investors' hopes. But regulators say that only institutional investors, such as pension funds and hedge funds, can buy them. Fans seeking a slice of the profits from the next instalment of “X-Men” must wait.

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Ranking economic policies

Not quite a row of sixes

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The World Bank reveals what it thinks of its clients

ARMENIA and Zimbabwe belong at opposite ends of any alphabetic roll call of nations. They also belong at opposite ends of the World Bank's pecking order of developing countries, which it has unveiled for the first time. Each year the bank gives countries between one and six marks for their efforts to do the sort of things of which it approves, such as curbing budget deficits, keeping tariffs low and even narrowing the gap between the sexes and looking after the environment. Armenia scored 4.3 overall; Zimbabwe 1.8.

Points mean prizes: the 16 indicators help decide who gets what from the pot of $33 billion the bank can disburse to its poorest members over three years. Until now, the bank had let on only which of five broad tiers countries fell into. Now everyone's score is on the bank's website for all to see.

Armenia tops the class largely because of its stunning macroeconomic record. Its GDP grew by 14% in 2005, whereas Zimbabwe's shrank by 6.5%. Armenia's inflation rate is lower than Japan's (it has done almost too well, you might say). Prices in Zimbabwe, where official statisticians track the debauching of the currency with admirable precision, rose by 1,193.5% in the year to May.

The bank's assessments draw on the judgment of staff *in situ* and in Washington, DC, guided by a detailed questionnaire. A country deserves four marks out of six for its trade policy, for example, if its average tariff is less than 16% and its customs houses run smoothly, marred only by the odd demand for “tea money” to speed things up. A country where women cannot easily request a divorce and where female genital mutilation is neither a crime nor uncommon would score just one for gender equality.

The indicators faithfully mirror “the evolution of the development paradigm”, as the bank puts it. They provide a long checklist of things that matter, but no sense of the proper sequence of them, nor of trade-offs between them. To earn full marks for fiscal policy, for example, a country must show it can cut public spending in economic adversity without “jeopardising the quality and quantity of public goods”. The sprawling range of concerns, from current-account deficits to teenage pregnancy, bespeaks broad-mindedness. But, in practice, countries that score well on one of the indicators tend to do well on most.

The bank deliberated at length before disclosing its ratings. Some outside advisers did worry that publishing the results might spook investors or tempt politicians to “abuse the ratings for political gain”. But if an enterprising politician were to use a poor score to press for reform, the numbers might do as much good as the money that follows them.

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About sponsorship

Economics focus

Intricate workings

Jun 15th 2006
From The Economist print edition

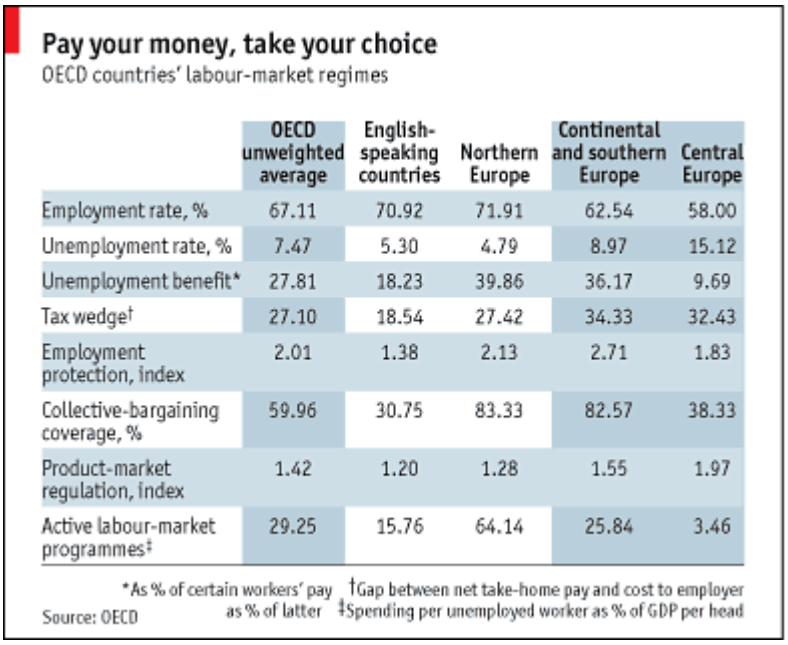
Tackling unemployment requires a careful mixture of policies

A DOZEN years ago the OECD published its Jobs Strategy, a list of recommended ways in which governments (mainly in Europe) might reduce high and persistent unemployment rates. The list was short: ten points and fewer than 200 words. This week the OECD "restated" the strategy at six times the length, arranging 20 recommendations in four "pillars". In part, the extra text is pure verbiage. In part, though, the list is longer because, 12 years on, there is much more to be said about which policies work and which do not, and about what should be done next.

The original list was succinct largely because it carried a broad, simple message: get more people into work, mainly by loosening labour markets. The new version, backed by the OECD's annual *Employment Outlook*, which contains a thorough review of recent research, takes a less clearly deregulatory line. "There is no single road to better labour markets," the OECD's secretary-general writes. That there is no single road, however, does not mean that there are many.

In broad terms, since 1994 most OECD countries' labour markets have improved: unemployment rates (the proportion of the workforce looking for jobs) have fallen; employment rates (the proportion of working-age people in jobs) have risen. Some countries, such as Australia, Britain, Denmark and Ireland, have seen marked improvement in more than one of these measures. But in other countries, notably France, Germany and southern and central Europe, too few people are in work. And although the general picture has improved in most places, some groups have done far less well than the average. In some countries, says the OECD, more could yet be done to bring women into the workforce or to make young people outside school or university easier to employ. One group of special concern is people aged 55 or over. Although 70% of Swedes and 61% of Americans aged 55 to 64 work, a mere 32% of Austrians and Belgians in that age range do. Too many countries have allowed or even encouraged older workers to drop out early. Unless that is reversed, the rise in the average age of populations may cause economic strain.

The *Employment Outlook* sifts study after study of which policies have done best. Over the years, economists have listed many things that can gum up labour markets. Generous unemployment benefits, especially those that last a long time, can blunt the incentive for those who lose their jobs to seek new ones. High minimum wages and tight job-protection laws can make employers loth to take on new employees, especially young ones who are untrained and untried. A thick wedge of taxes between what workers take home and what it costs to employ them can both discourage people from working and make firms reluctant to hire them. People without jobs may lack the education or skills that employers require.



Pay your money, take your choice

OECD countries' labour-market regimes

	OECD unweighted average	English-speaking countries	Northern Europe	Continental and southern Europe	Central Europe
Employment rate, %	67.11	70.92	71.91	62.54	58.00
Unemployment rate, %	7.47	5.30	4.79	8.97	15.12
Unemployment benefit*	27.81	18.23	39.86	36.17	9.69
Tax wedge†	27.10	18.54	27.42	34.33	32.43
Employment protection, index	2.01	1.38	2.13	2.71	1.83
Collective-bargaining coverage, %	59.96	30.75	83.33	82.57	38.33
Product-market regulation, index	1.42	1.20	1.28	1.55	1.97
Active labour-market programmes‡	29.25	15.76	64.14	25.84	3.46

*As % of certain workers' pay as % of latter †Gap between net take-home pay and cost to employer ‡Spending per unemployed worker as % of GDP per head

Source: OECD

Several countries have tried to ungum labour markets by deregulating them, by trimming marginal tax rates and by making benefits less generous. Broadly, these policies have raised employment. However, this has not been the only route. In essence, says the OECD, its members can be divided into four groups: two successful, in that they have lower unemployment and higher employment rates than the average, and two not. The fortunes of the four groups are summarised in the table.

You take the high road

The first group, labelled "mainly English-speaking" by the OECD (Japan, South Korea and Switzerland are honorary Anglophones), tends to have weaker job protection, less generous unemployment benefits and thinner tax wedges than the average. Its employment rate is comfortably higher than the OECD average; its jobless rate is comfortably lower. In the second, "northern European" group (Scandinavia, the Netherlands, Austria and Ireland), taxes and unemployment benefits are high and workers hard to fire. Yet the average employment rate is a little higher than the first group's and the unemployment rate a little lower.

There are two reasons why the second group can match the first. Their product markets are, like those of the first group, fairly loosely regulated, making the whole economy more dynamic. And they spend much more on schemes intended to ensure that the unemployed try hard to find work: in return for high benefits, they must accept that their search for a job will be closely watched and that some work-seeking programmes may be compulsory. That high unemployment benefits are a disincentive to seek work is not in doubt; but it seems that a sufficiently diligent and well-funded employment service can offset their effects. So if governments dislike gross inequality of income between those with jobs and those without, they can both avoid it and maintain the incentive to look for work—at a cost in taxes.

Countries in the third group—mainly southern European ones, plus France and Germany—tend to pay high benefits too. But they have not offset these with labour-market programmes on the scale of the second group, and their product markets are more protected. In the last group, which includes the Czech Republic, Poland and Slovakia, benefits are low. But workers are not especially easy to fire; little is spent on pushing the jobless into work; and product markets are more regulated than in any other group.

Next, says the OECD, many countries need to do more to bring specific groups into work. Arguably, as populations age, older workers will be the most important of these. Wages are often based on seniority, not productivity, making some older workers relatively dear to employ. Pension schemes in many countries encourage early retirement—in effect, levying an implicit tax on remaining in work in your 60s. This tax has fallen in some countries in recent years, but has gone up in others. Some of the OECD's members have done well at getting more of their people into jobs. Most still have a lot to do.

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Los Alamos National Laboratory

A good enough performance?

Jun 15th 2006
From The Economist print edition

America's most famous weapons laboratory is under new management

ON JULY 16th 1945 the skies of New Mexico lit up and a thunderous roar whooshed across the desert. Los Alamos National Laboratory has been living ever since on the reputation it won from that history-changing event, the explosion of the first atomic bomb. But smugness can breed complacency, and complacency carelessness. In recent years the laboratory has been in the news not for its successes but its failures. A series of farcical events, ranging from secret data going missing (only to be discovered behind a copying machine) to false charges of espionage being laid against an American scientist of Chinese descent, led the then director, Pete Nanos, to describe his staff as “cowboys” and “butt-heads”, and to close the place down for seven months in 2004, to try to clean things up.

The result is a change of management. At the beginning of June the University of California, which had run Los Alamos since the days of the Manhattan Project, ceded control to a consortium known as Los Alamos National Security. Though the university remains one of the consortium's members, it will now share what bouquets and brickbats come Los Alamos's way with three firms that make a lot of their money as military contractors. These are Bechtel and Washington Group International, two large engineering and construction companies, and BWX technologies, a concern that specialises in managing nuclear facilities.

Unlike the university, the new consortium will be aiming to make a decent profit from its activities. It is also thought likely to change the emphasis of the laboratory from research (in a wide range of subjects, not all of them to do with defence, let alone nuclear weapons), to the more mundane business of making the detonators of nuclear warheads.

The consortium is making reassuring noises. According to Jeff Berger, its director of communications, “There is a popular misconception that we're out to change the lab's mission.” Nevertheless, many of Los Alamos's researchers sense a shift of direction. Indeed, quite a few have left. That, though, is hardly the point. The question is whether any change that does come will serve America's national interest.

Times they are a'changing

Los Alamos is one of three national nuclear-weapons laboratories that sit in the American West under the watchful eye of the Department of Energy. (The other two are Lawrence Livermore, in California, and Sandia, which has establishments in both California and New Mexico.) For years, weapons were their sole mission. Then the cold war ended and they had to find other things to do, as well.

Part of this change was a logical extension of what they had been up to in the past. Rather than producing new weapons and conducting tests (which America stopped in 1992, even though it has not ratified the Comprehensive Test-Ban Treaty, which bans such tests), they shifted their emphasis towards making sure that the country's ageing warheads remained safe and usable. Since they could no longer pluck warheads out of the arsenal at random to test by letting them off, they ended up building huge computing centres to process the complex “virtual” tests that replaced the real thing. Having built these, it made sense to use them for other things. That, in turn, led to the sort of diversification that might be praised in a commercial organisation where the main product was going out of fashion, but risked looking suspiciously like job-justifying mission-creep in a taxpayer-funded bureaucracy.

All three laboratories did this. But only one of them found itself in the newspapers for all the wrong reasons. Since many experts in the field have wondered noisily whether three weapons labs is one too many, such poor publicity was not clever.

Unfortunately for Los Alamos, some of its biggest critics are on the Congressional Committee on Energy and Commerce. During a hearing in May 2005, Congressman Bart Stupak chastised the laboratory, the University of California and government officials for years of mismanagement. Exasperated, he asked a pair of obvious questions: “Why do we have to have this place any longer?” and “Is there any really unique science that can only be done at Los Alamos and nowhere else?” It is that last point in particular that the new managers must address.

Regardless of which way you look at it, a lot of good “off-mission” science has been done at Los Alamos. Its researchers have, for example, developed ways to handle what is known as supercritical carbon dioxide. The result is an environmentally friendly solvent—certainly more environmentally friendly than many of the noxious alternatives used for industrial cleaning. The technology has been picked up by businesses ranging from dry cleaners to semiconductor-makers to cut back on the contaminants they produce.

The laboratory's expertise in energy technology has also been put to good use in research in the fashionable area of fuel cells and into superconducting tape for electricity transmission. This tape, which can carry 100 times as much current as an equivalent chunk of copper wire, may eventually be used to replace bulky transmission lines. And the futuristic computer centre, which allows researchers to manipulate graphical representations of nuclear data with their hands, as if physically flipping through a book, may also be put through its commercial paces. It is said to be the object of covetous eyes at Disney.

The laboratory's officials like to point out that its work on safety has many possible uses. In its quest to study how radioactive material might disperse, Los Alamos has concocted models for the spread of everything from infectious diseases to air pollution. City governments have tapped into the pollution expertise, while researchers from other laboratories have borrowed the epidemiological tricks to model the spread of AIDS.

Perhaps, though, the best example of how Los Alamos's largesse can help civilians is the Isotope Production Facility. This research unit can churn out rare and expensive radioactive isotopes for medical use—particularly in cancer therapy. Such a facility, officials argue, could not be supported by the private sector, because it would be too expensive. But given that Los Alamos needs it anyway, it can be turned to medical work from time to time.

It is this sort of diversity that many of the laboratory's scientists would like to keep. Others, however, have decided which way the wind is blowing and left.

Angel Garcia, a renowned biophysicist, has, for example, gone to Rensselaer Polytechnic Institute in New York state, where he will continue to work on the crucial question of how proteins fold into the right shapes to do their jobs properly. One of the laboratory's best-known computer scientists, Wu-chun Feng,

has decamped to the Virginia Polytechnic Institute. Another, Erik Hendriks, has left for Google. And an entire team working in the burgeoning field of bioinformatics has formed a new laboratory at the Virginia Bioinformatics Institute.

The way that these and other researchers have been gobbled up by the outside world suggests that Mr Stupak and the other congressional critics have a point. Bioinformatics and protein-folding theory are both crucial to the development of biological understanding, but there is no reason to doubt that the researchers will thrive in other institutions. Indeed, an establishment doing highly classified work, with the security to match, may not really be the right place for civilian biologists, however distinguished they are.

The computer scientists are a greater loss. In the absence of real weapons tests, computing is at the core of the laboratory's work. If the übergeeks start leaving in numbers, that work will get harder to do.

On the other hand, from the scientists' point of view, this exodus may prove far-sighted. For there may come a time when even making the detonators of nuclear weapons might look like part of a rosy future that never was.

The lab-rats leave the sinking ship

At the moment, having closed the Rocky Flats Plant in Colorado, America relies on Los Alamos for the production of plutonium pits, as these detonators are known. Most of today's American nuclear warheads were made in the 1980s and have been deteriorating slowly ever since. Hence the need for new detonators. But Congress now wants to do more than just maintain the existing arsenal. In 2005 it authorised what is known as the Reliable Replacement Warhead Programme, to explore new ways of making warheads like those in the existing stockpile, so that they are safer, more reliable and less toxic. Los Alamos's researchers are in competition with those at Lawrence Livermore to come up with a design for these warheads.

The Nuclear Weapons Council, composed of officials from the Department of Defence and the Department of Energy, will decide later this year which of the two laboratories' designs is the winner. If the winning design actually gets built, and the indications so far are that it will be, a further reorganisation of the national laboratories would be almost inevitable. If Los Alamos loses the reliable-warhead competition, it could find itself in the humiliating position of being a sub-contractor turning out the Livermore design.

Despite the noises, a total shutdown is unlikely. Too many sensitive jobs—not just those of the researchers, but of the thousands of support staff at the laboratory—are at stake for New Mexico's representatives in Congress to let the place close. But the next year or two will see the old way of doing things tested severely, as the new managers impose their will and that of Congress. It may not be a test to destruction, but there will be nothing virtual about it. It will be very real indeed.

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How to make a butterfly

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From The Economist print edition

This butterfly is an example of a Central American species called *Heliconius heurippa*. Or, rather, it isn't, for it was bred in a laboratory by crossing two other species of *Heliconius*. As they report in *Nature*, Camilo Salazar of the University of the Andes, in Colombia, and Jesús Marávez, of the Smithsonian Tropical Research Institute, in Panama, have shown experimentally that *H. heurippa* is a species formed by hybridisation in the wild. Two species have, in other words, merged into one, rather than one splitting into two, as usually happens during the course of evolution. *H. heurippa* does not crossbreed with its ancestors because species-specific wing markings signal that it does not belong to them. They thus avoid mating with it, so it is free to carry on evolving by itself.

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AIDS

Nef off

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The reason HIV is so virulent may have been found

Get article background

THE human immunodeficiency virus, HIV-1, the cause of the global AIDS epidemic, is the most intensively studied pathogen in history. For all that, it still has secrets to reveal. One is why it is so deadly. Many of man's primate relatives in Africa harbour similar viruses. Yet as far as can be seen, these so-called simian immunodeficiency viruses (SIVs) have little impact on their hosts' health.

Frank Kirchhoff and Michael Schindler, of the University of Ulm, in Germany, and their colleagues have been looking into why that is. Their investigation, just published in *Cell*, suggests it is the result of a change in the role of a single viral gene, called *nef*.

They came to this conclusion by looking at those simian equivalents. In most SIVs, they found, one role of *nef* is to remove a protein called TCR-CD3 from the surfaces of the cells that host the virus. The host cells in question are immune-system cells called T-cells. Specifically, they are “helper” T-cells, which orchestrate the immune system's response to pathogens such as viruses.

The way the body recognises an infection is by examining molecules from the infectious agent. These molecules, known as antigens, are picked up by so-called antigen-presenting cells that display them on their surfaces and show them to the helper cells. The job of TCR-CD3 is to assist in the recognition of these antigens. If a helper cell recognises an antigen, it becomes activated. This means that it starts secreting chemicals that stimulate the growth and multiplication of other T-cells, including the killer T-cells that destroy infected cells. Then, its job done, it dies.

Usually, this response clears the infection. In the case of AIDS, though, it does not. That means the immune system continues to be stimulated, and this prolonged stimulation results in high death rates among T-cells. Eventually, that exhausts the immune system's capacity to regenerate itself. The result is a collapse in the number of T-cells, and the accompanying symptoms of AIDS.

In most simian infections, this does not happen because *nef* keeps the TCR-CD3 level too low for this exaggerated response to occur. That is also true in a rarer form of human AIDS caused by a virus called HIV-2. This form of AIDS is found in West Africa, but has not spread much beyond that part of the world. Indeed, of the 16 immunodeficiency viruses the researchers looked at, all but five had *nef* genes that removed TCR-CD3 from the cell surface. Three of those five were closely related monkey viruses. The fourth was HIV-1.

The fifth was the chimpanzee virus that is the direct ancestor of HIV-1. Mankind, it seems, was just unlucky that this virus made the leap across the species barrier. If the only barrier-leaper had been HIV-2 (which is the descendent of a TCR-CD3-controlling monkey virus), AIDS might be a localised phenomenon in a few West African countries, rather than one of the biggest problems faced by humanity.

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Suicide and antidepressants

Pep pills

Jun 15th 2006
From The Economist print edition

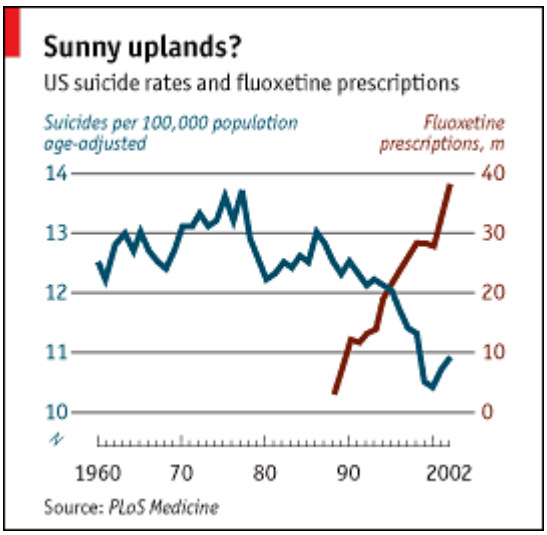
Evidence that Prozac stops people committing suicide

CORRELATION is not causation, but it can often be suggestive. That is the best spirit in which to examine the observation that suicide rates in America have fallen by around 15% since the introduction of fluoxetine, or Prozac, as it is trademarked by its inventors, Eli Lilly.

Prozac is the best-known and most widely used member of a class of anti-depressive drugs called selective serotonin re-uptake inhibitors (SSRIs). Serotonin is one of the messenger molecules that carry signals between nerve cells in the brain. These molecules are secreted into junctions called synapses, where nerve cells abut one another, and when they have done their job they are absorbed back into the cells that secreted them, a process called re-uptake. Clinical depression is often associated with low levels of serotonin. SSRIs block serotonin re-uptake, boosting its concentration in the synapse. The hope was that this would alleviate the symptoms of depression—and with many day-to-day symptoms it did, spectacularly.

The most serious symptom of depression, though, is a one-time event—suicide. Though different studies have come up with different answers, it seems that between 2% and 6% of those with clinical depression kill themselves, and that depression is a factor in about half of suicides. A group of researchers at the University of California, Los Angeles, led by Julio Licinio, therefore decided to ask whether Prozac might have affected these numbers. Their study, just published in *Public Library of Science Medicine*, does not prove that it has, but it is quite suggestive.

Dr Licinio and his colleagues obtained their data on suicide rates from America's Centres for Disease Control, which monitor's the country's health, and also took into account the changing age-structure of the country's population, as reported by the census bureau. Data on prescription drugs are not recorded officially, but a firm called IMS Health, which makes a business out of collecting and selling health-care information, has a database of prescriptions issued by 20,000 pharmacies around the country, and the researchers were able to make use of this.



The result, shown in the chart, is a strong inverse correlation between the deployment of Prozac and the suicide rate. The average rate from 1960 to 1988, the year that Prozac came on the market, was 12.8 suicides per 100,000 people each year, and although this figure varied somewhat from year to year, it showed no clear trend. Indeed, the rate remained almost unchanged, at 12.9, when Dr Licinio and his team looked all the way back to 1870. By 2002, however, it had fallen to 10.9. The researchers reckon that if this fall can truly be ascribed to Prozac and its kin, those drugs have saved somewhere between 22,000 and 45,000 lives in 14 years.

One reason this observation is important is that there have been persistent suggestions that some SSRIs, Prozac among them, actually cause suicidal thoughts in certain people who did not previously suffer from them. There is no evidence that such thoughts have been converted into action. Indeed, Eli Lilly has successfully defended itself against several plaintiffs who have sought to suggest otherwise. But the shadow lingers.

Again, correlation is not causation, but if SSRIs are causing suicides, then that effect must be small compared with whatever has been bringing the suicide rate down over the past decade. Whether SSRIs can, in rare cases, provoke suicide, still bears careful investigation. By contrast, the placebo-controlled study that would be needed to show clearly that Dr Licinio's finding is more than a coincidence, and that Prozac and similar drugs really do save lives, cannot be conducted. It would require some people not to take the drug. And that would clearly be immoral.

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Quai Branly

Gallic grandeur

Jun 15th 2006 | PARIS
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Amid controversy over immigration and the proper role of ethnography, Jacques Chirac prepares to open a major new museum in the city that launched his career

IT HAS become a tradition under France's fifth republic for each president to leave his architectural imprint on the Paris skyline. Georges Pompidou had his Pompidou Centre, completed after his death. François Mitterrand sprinkled across the French capital a pyramid in the courtyard of the Louvre, the Bastille opera house, a grand arch and a national library. Now, in the twilight of his presidency, Jacques Chirac too is about to have his turn.

On June 20th the French president will inaugurate the Musée du Quai Branly, the city's biggest newly built museum since the futuristic-looking Pompidou Centre opened nearly 30 years ago. Standing in the shadow of the Eiffel Tower, Quai Branly is devoted to the “art and civilisation of Africa, Asia, Oceania and the Americas”.

The museum startles in many senses. It is a modernist architectural gem in the heart of historic Paris. It is a controversial project devised by a president who is better known for his conservatism. And it is a symbolic effort to reach out to non-European civilisations at a time when France is having particular trouble digesting the offspring of such cultures at home.

Eleven years in the making, the *euro*232.5m ($293m), state-financed project began as Mr Chirac's bid to counter “the arrogance and ethnocentrism” of Europe's museums and to create a prestigious home for the world's “forgotten civilisations”. Long fascinated by statues and masks from Africa and Asia, Mr Chirac has been known to portray himself as the defender of the world's downtrodden against the march of American-led Western cultural imperialism. “Against those who preach confrontation, violence, hate,” he declared two years ago, the museum would send “the humanist message of respect for diversity and the dialogue of cultures”.

From the start, the plan was to exhibit works that were already to be found in Paris, split between the Musée de l'Homme and the Palais de la Porte Dorée. Some 300,000 objects—masks, stools, statues, musical instruments, textiles, costumes, jewellery, ceramics—have been assembled, cleaned, documented, tagged, photographed and put online for the use of researchers. Like the Pompidou Centre,

Quai Branly is designed not only to attract one-off tourists but regular visitors and students with research interests, providing them with a library and classrooms. Of the stock, some 3,500 items will be on permanent exhibit at once, and many of those in storage will be visible in a glass-fronted central circular vault.

On the banks of the Seine in the capital's swanky seventh arrondissement, the museum insolently interrupts the neighbouring streets of 19th-century Haussmann apartments. Perched on ten-metre-high (33 feet) curved supporting pillars, rather like a grounded spaceship, it is set back from the road in a landscaped garden. Created by Jean Nouvel, designer of the Institut du Monde Arabe, also in Paris, and of the Torre Agbar in Barcelona, it is a startling architectural composite. Inside, a wide white suspended ramp, winding gently upwards across the main exhibition hall, recalls Frank Lloyd Wright's Guggenheim Museum in New York. Outside, a horizontal row of two dozen giant, Lego-like boxes protrude from the riverside façade, painted in earthy tones of aubergine, ochre and tan.

Geometric shapes meet flowing curves; plate glass meets natural wood; concrete meets vegetation. Detractors lament the architectural medley. But the overall result is oddly harmonious, perhaps because of the linking theme of nature. Once the trees planted on it mature, the site will be shaded and woodlike. There is even an extraordinary 800-square-metre “vegetation wall”: a vertical garden in which 150 different plant species have taken root on polyamide felt, stapled to waterproof PVC slabs and fed by automatic hosepipes. Mr Nouvel said he wanted to create space organised around “the symbols of the forest, the river and the obsessions of death and oblivion”.

The museum's permanent collection is made up of traditional artefacts, arranged mainly by geographical region. It includes familiar items, such as Kota reliquary figures in wood, brass and copper from eastern Gabon, as well as rare treasures, such as the tenth- or 11th-century Djennenké pre-Dogon statue from contemporary Mali, carved in wood and standing nearly two metres high. No dusty corners or cramped drawers of curiosities here, just dimmed lighting and big white spaces. The central idea is to dignify traditional art, and, says Stéphane Martin, the museum's director, “to put non-European culture on an equal footing with other civilisations”. To this end, Quai Branly's original working title “Museum of Primary Arts” was dropped because of its association with the primitive and replaced with a neutral reference to the museum's location.

The project has stirred much controversy, however. Inevitably, ethnologists have decried the *décontextualisation* of artefacts that were never designed as aesthetic objects, but for practical, mystical or ritual purposes. Scholars from the two museums that surrendered their collections are particularly disgruntled. Yet why treat an ancient Greek vase as art and not a Zulu headrest? It was a collection of African masks in Paris, after all, that in 1907 inspired Picasso to explore abstract representation. He was moved, he said, by “the sublime beauty of sculptures executed by the anonymous artists of Africa.”

Point for reflection

More awkward, perhaps, is the symbolism of Quai Branly. The permanent collection's exclusive emphasis on traditional artefacts sits uncomfortably with the efforts by younger curators these days, in cities such as Johannesburg, to confront such tribal clichés of Africa. They contest the way African art is ghettoised and exoticised. Contemporary artists deal in tin, metal, recycled industrial materials. They want to show that Africa too can be modern, gritty and urban.

Mr Martin replies that the permanent collection is but a “starting point for reflection”; the museum “will explore the world in its modernity too” through temporary exhibitions, debates, dance and theatre. Part of one building, for instance, has been decorated to delightful effect by eight Australian aboriginal artists. This includes the ceiling of the museum shop, painted in warm hues of red, orange, white and black, in a fine woven cross-hatch interspersed with sun-like circles. The point, argues Mr Martin, is not to dwell on the past but to offer to French people of immigrant origin a cultural reference that is “not only Louis XIV or the Impressionists”.

Whether the youths of the Paris *banlieue*, whose anger exploded in rioting on the streets last autumn, stream in to admire the art of their ancestors remains to be seen. Entrance to the garden is free, as is access to the roof-top terrace with its stunning view. As for Mr Chirac, a former mayor of Paris, he may have little to show politically for his decade in power, but he has at least helped to bequeath something of value to the city that launched his political career.

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Maps

Placing names

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IN AN ideal world, each place would have one name which would be the same in every language. Yet politics, history and language rule out such simplicity. Sometimes the difference is minor (Londres, Londra, Londyn, Londen, Lontoo, Londynas and Londinium are all recognisable forms for the British capital). But place names can be outright baffling: who but a Latvian would know that a signpost to Igaunija points to neighbouring Estonia?

From Squaw Tit to Whorehouse Meadow: How Maps Name, Claim, and Inflame
By Mark Monmonier

Chicago University Press; 215 pages; $25 and £16

Buy it at
Amazon.com
Amazon.co.uk

Such variants are called exonyms by geographers. Among the many eyebrow-raising facts in this excellent book is that the United Nations has an official committee of geographers to discourage their use. Such tidy-mindedness has proved difficult to enforce over the past three decades. Talking in English about the Schwarzwald rather than the Black Forest would sound pretentious. For untranslatable names, transliteration and transcription (yes, there is a difference) between languages and alphabets inevitably creates unauthorised variants. How on earth do you spell Warsaw if your language lacks the letter “w”?

And that is just the start of it. The real problems start when politics comes into play. One of the few things that poor countries can do to get the world's attention is to re-label themselves. East Timor recently became Timor-Leste; Upper Volta is now Burkina Faso; Zaire was Congo and is now Congo again (confusingly, so is its neighbour); Burma is Myanmar (at least for the ruling junta; the opposition prefers the old name). Name changes often try to shed relics of colonialism, real or perceived (so Mumbai for Bombay, Beijing for Peking).

Mostly, that just creates a lucrative line in new maps and atlases. But sometimes it also causes huge controversy. In theory, Macedonia, independent since 1991, is still struggling to persuade the world that it is entitled to that name. To placate next-door Greece, which fears separatism by the Slavs in its own province of Macedonia, it languishes under the clumsy “Former Yugoslav Republic of Macedonia”, or FYROM. Such nomenclature is shorthand for political affiliation: if you speak of “Judea and Samaria” you are a Likudnik; if you call the same patch the “occupied territories” you are not.

The author is an able populariser of academic geography, and an expert guide to the bureaucratic, legal and political hierarchies that determine how places acquire, change and lose their names. His eye-catching title reflects the big argument about names in his home country, America. Two strong tides, one of prudery and the other of political correctness, are eroding a verbal landscape created by centuries of cartography and local usage. Now that “nigger” (which he calls the N-word) has become taboo in polite society, what happens to Niggerhead Point?

The charm of the offensive

The author notes in passing that this cape on Lake Ontario was thus named because it was a point on the laudable underground railroad that helped thousands of escaped slaves to freedom in Canada. That interesting historical association survives in the first name change, to Negrohead Point (which remains on federal maps). But to call it merely Graves Point (as New York state maps do) seems a pity.

“Nigger” and “Jap” are now banned on American maps, though a Dago Gulch survives in western

Montana. More puzzling to the non-American is the onslaught on the use of “Squaw”, which according to some activists (though not philologists) is not an innocent word for a Native American woman, but a derogatory term for her vagina. So Squaw Peak is now set to be renamed after Lori Piestewa, the first Native American woman in the American army to be killed in combat.

Names with risqué connotations, be they deliberate or coincidental, fare a little better. Gayside in Newfoundland became Baytona in 1985, apparently in response to local homophobia. And Dingle Hole in New York was listed as a problem name, because dirty-minded officialdom smelt a resemblance to a gay slang word, “dingleberries”. Attempts to rename the village of Dildo, Newfoundland, have foundered on strong local opposition. Whorehouse Meadow in Oregon was renamed Naughty Girl Meadow in the 1960s, but has recovered its old appellation.

The author is clearly blessed with a good sense of humour, which, sadly, he partially suppresses, presumably in deference to the stiff-necked culture of American officialdom and academe. Another, odder, weakness is the illustrations: the maps in the book are cheap, monochrome reproductions, and there is no attempt to show what Bloody Dick Creek and Molly's Nipple look like in real life.

But the bigger point is well made. Maps are about power: the rich, powerful and victorious determine place-names, just as they write history. The final defeat for losers is when they are wiped off the map.

From Squaw Tit to Whorehouse Meadow: How Maps Name, Claim, and Inflame.
By Mark Monmonier.
Chicago University Press; 215 pages; $25 and £16

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About sponsorship

Twitching on the Tigris

Birds of fray

Jun 15th 2006
From The Economist print edition

IN EARLY 2004 Jonathan Trouern-Trend of the Connecticut National Guard started a year-long posting in Iraq. A birdwatcher since he was a boy, he used his spare time on base, and on trips “outside the wire”, to look for birds, and wrote about the 122 species he saw in the Gulf in a blog that attracted thousands of readers. This tiny, beautifully illustrated book, produced in the style of a birdwatcher's diary, collects together the highlights of his online journal into a gentle war memoir that conveys a simple message of hope.

Birding Babylon: A Soldier's Journal from Iraq
By Jonathan Trouern-Trend

Sierra Club Books; 79 pages; $9.95

Buy it at
Amazon.com
Amazon.co.uk

Mr Trouern-Trend was stationed at Camp Anaconda, one of America's biggest bases, in the Sunni triangle north of Baghdad. Although under almost daily mortar and rocket attack, the camp was full of wildlife; “a refuge of sublime natural beauty to those who looked.”

Despite the effort of birdwatching in “full battle rattle”, and the searing desert heat, Mr Trouern-Trend delights in the antics of the birds he sees: a spectacular Smyrna kingfisher perching on the reeds of the pond by the base laundry; white-cheeked bulbuls chasing each other in the tamarisk trees; wood pigeons unfazed by the roar of F-16s tearing down the runway; a flock of white storks riding a thermal “never once flapping their wings as they spiralled up higher and higher”.

What makes this little book special is the author's joy that “something worthwhile or even magical” could take place amid the horror of war. “Knowing that the great cycles of nature continue despite what people happen to be doing is reassuring,” he writes. “There is an order we can take comfort in and draw strength from.”

Although the chaos in Iraq continues, those great cycles have already started to repair the damage. Iraqi ornithologists have begun surveying the birds of the country's southern marshes, which stretched for 20,000 square km (7,722 square miles) until they were drained and destroyed by Saddam Hussein's government. Some species feared extinct have recently been seen. Life goes on.

Birding Babylon: A Soldier's Journal from Iraq.
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Sierra Club Books; 79 pages; $9.95

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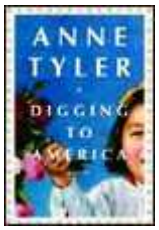
New fiction

Asymmetric conversions

Jun 15th 2006
From The Economist print edition

FOR Anne Tyler fans, her new novel leads straight to familiar territory: family dynamics; Baltimore backdrop; characters so richly drawn you would recognise them in the street. Its sweep, however, is broader than that of many of her previous books and focuses on identity, belonging and what it is to be American.

Digging to America
By Anne Tyler



Knopf; 277 pages; $24.95.
Chatto & Windus; £16.99

Buy it at
Amazon.com
Amazon.co.uk

"Digging to America" starts at Baltimore's airport in 1997. Two couples await the arrival of baby girls they have adopted from Korea. All-American Bitsy and Brad Donaldson—wearing badges proclaiming "Mom" and "Dad"—are surrounded by a noisy, balloon-carrying, camera-wielding entourage of family supporters. Standing quietly behind them are Ziba and Sami Yazdan, an Iranian-American couple, accompanied only by Sami's mother Maryam. A few weeks after this encounter Bitsy invites the Yazdans to a celebratory "arrival party", an event that is repeated annually and which Ms Tyler uses to mark the passage of an intense, if sometimes difficult, friendship.

Random House

Domestic goddess

The awkwardness stems from each family's idea of what constitutes cultural identity. Bitsy and Brad, despite being homespun, white-bread Americans, are desperate not to Americanise their daughter. They keep her Korean name, Jin-Ho, feed her "culturally appropriate" soy milk and for special occasions dress her in itchy, ethnic Korean clothes which she hates.

Sami and Ziba have spent years carefully assimilating themselves into American culture—they refuse to have any Persian rugs in their modern, suburban home—and cannot see what is so wrong with being American. They rename their daughter Susan, a Western name but also a "comfortable sound for Iranians to pronounce", dress her in jeans and Westernise her hairstyle.

Weaving together the novel's themes and characters is Maryam, whose finely honed portrait illustrates the author's ability to see America from an outsider's perspective. Reserved, elegant, self-contained, Maryam wants to belong, yet is unable to relinquish her outsiderness; after four decades in America she still yearns for Iran—the homely chatter of her long-dead aunts, the tinkle of the fountain in the family courtyard. But when she finds herself being wooed by Bitsy's widowed father she wonders if she has over-emphasised how different she feels—at the cost of her own happiness. "You can start to believe that your life is defined by your foreignness," she says. "You think everything would be different if only you belonged. 'If only I were back home,' you say, and you forget that you wouldn't belong there either, after all these years."

Tenderly observed and lifted by humour, "Digging to America" is a complex novel that asks if anyone can ever truly fit in. In answering that question Ms Tyler has woven her magic once again.

Digging to America.
By Anne Tyler.
Knopf; 277 pages; $24.95. Chatto & Windus; £16.99

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About sponsorship

Doing business in China

China bytes

Jun 15th 2006 | HONG KONG
From The Economist print edition

The challenges of starting a business in China can be clearly seen from the experiences of two computer companies, one Chinese and one Western

LENOVO is arguably China's most important company, rising from obscurity 20 years ago to become the world's third-largest manufacturer of personal computers. Its purchase, for $1.25 billion in late 2004, of IBM's PC division, which boasted four times its own volume of sales, still ranks as one of the most daring overseas acquisitions by a Chinese company.

Yet there was nothing inevitable about Lenovo's ascent. Its founder Liu Chuanzhi was determined and politically shrewd. But as Ling Zhijun, a respected Chinese journalist, chronicles in this exhaustive new account, Mr Liu and his colleagues—most of whom started in business in their 40s—had no experience of running a private company, no idea about modern computers (the first mainframes had to be cooled with ice cubes and a fan) and a formal education that had been cut short by the Cultural Revolution. As they built Lenovo, whose Chinese name is Lianxiang, they had to teach not just themselves, but a generation of Chinese bureaucrats how to run and regulate a private corporation.

Mr Ling's impeccably sourced, fly-on-the-wall account of the company's struggles is fascinating. Lenovo depended on the protection and goodwill of the Chinese Academy of Sciences, which also became its biggest shareholder. However, despite Lenovo's subsequent stockmarket listing in Hong Kong and its skill in sidestepping ludicrous government rules against everything from differential pay and bonuses to control of the supply chain, the book attributes Lenovo's success a little too often to its state shareholders. Ownership of private assets is highly sensitive in China, and previous attempts by the government to reclaim ownership of effectively private companies have often proved disastrous—bankrupting Kelon, a fridge-maker, for example. With luck, Lenovo will escape this fate.

Mr Ling gives most of the credit for Lenovo's success to Mr Liu, who pushed boundaries while staying just the right side of the ideological line—and by doing so, changed the way China does business. Mr Liu launched incentive schemes and share options to motivate Lenovo's staff—handing out suitcases of cash and risking imprisonment to sidestep the government's 300% tax on bonus payments. The tax was subsequently scrapped. He pushed for a handful of employees to own their own homes—a revolutionary initiative in 1992—prompting China Construction Bank to announce the nation's first- ever personal loans and newspaper headlines to cry: “How can young people live in three whole rooms?” Lenovo was the first Chinese company to create advertisements that did more than just name a product and its price—so introducing brand building to China. And Mr Liu accepted China's limits. Though politicians and his own engineers urged him to develop a “Chinese chip” and fight Western competitors on quality, Mr Liu resisted. Seeing that Chinese science lagged behind, he focused instead on cutting prices and copying Western technology and sales methods.

Mr Ling's book is, however, a history. Despite its title, it offers no new detail about the IBM purchase that propelled Lenovo onto the world stage. Most mergers between Chinese and Western companies stumble.

The Lenovo Affair: The Growth of China's Computer Giant and its Takeover of IBM-PC
By Ling Zhijun. Translated by Martha Avery

John Wiley; 375 pages; $24.95 and £16.99

Buy it at
Amazon.com
Amazon.co.uk

Guanxi: Microsoft, China, and Bill Gates's Plan to Win the Road Ahead
By Robert Buderi and Gregory T. Huang

Simon & Schuster; 306 pages; $26

Buy it at
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Insiders suggest this one may be faring better than most under William Amelio, the former head of Dell's Asia-Pacific division. It is too early to know for sure and Lenovo's history may be a poor guide to its future.

If Lenovo's rise in China has been haphazard, Microsoft's feels pre-programmed. Opening a research laboratory in China in 1998, a pioneering move for a foreign company, was a calculated decision intended to help Microsoft attract fresh, cheap talent. That, combined with an investment of more than $100m, helped repair relations with Beijing that had been damaged by the group's heavy-handed commercial dealings in China.

On most fronts, it has worked. On his first visit to China in 1994, Microsoft's chairman, Bill Gates, was treated frostily by China's then president, Jiang Zemin. By the time he returned in 2003, the two were exchanging jokes. And the lab certainly attracted top-flight talent. In “Guanxi”, Robert Buderi and Gregory Huang, both technology journalists, describe one example after another of the clever scientists that were hired by Microsoft. Yet despite 750 published scientific papers and 72 technologies transferred into Microsoft products in its first five years, the Beijing lab now appears to be losing ground to Google, Nokia and Sony. After a bitter court battle, Lee Kai-Fu, Microsoft's top Chinese scientist and the founder of the Beijing lab, left in 2005 to join Google.

Both books suggest that China has the raw material—smart, driven, educated people—it needs to push its high-tech ambitions. Yet managing those people while navigating an opaque bureaucracy and an unpredictable business environment matters just as much as writing code or designing hardware—and will determine whether China can move from the world's workshop to becoming a serious force in global technology.

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About sponsorship

Yasser Talal al-Zahrani

Jun 15th 2006
From The Economist print edition

Yasser Talal al-Zahrani, a prisoner in Guantánamo, died on June 10th, aged 21

Getty Images

NOTHING much distinguished Yasser Talal al-Zahrani from the 500 or so other prisoners held by the Americans at Guantánamo Bay, in Cuba. In his loose-fitting orange clothes and flip-flops, he spent the long days sitting or lying in his wire-mesh cell. He washed with water from one bucket, made water in another.

Five times a day, when the call to prayer came over the camp PA system (sometimes overlaid, or garbled, with announcements in English), he would spread a towel on the cement floor and pray. At least it was not hard to determine Mecca's direction. The sun blazed in through the mesh and baked the roof of corrugated iron. If he left his cage to be escorted, in leg shackles, to interrogation or the hospital, humidity quickly soaked his shirts with sweat.

In his letters home, Mr Zahrani told his father he was behaving well and had memorised the whole Koran. Guantánamo's guards, however, said he was troublesome, surly and a rule-breaker. Unlike some other prisoners, he was angry rather than depressed. He did not have a lawyer, indeed refused to have one. If there were points to be made about conditions and legalities, he would make them himself.

He was young, having come to the camp at 17. Whether he was innocent was a different question. Though born in Saudi Arabia, at 16 he was in Afghanistan: working for charities, his family said, or running guns for the Taliban, according to the Americans. After his capture, in Pakistan in 2002, he got involved in a prison riot in which a CIA agent was killed. As a dangerous element, he was flown to Guantánamo and kept there.

Like all but a handful of the detainees, he was not charged with anything. He was not, therefore, a proven criminal. But nor was he a prisoner-of-war. The conflict he had fought in had not been between states, but part of the amorphous war on terror that America had been prosecuting, against brutal but shadowy jihadist networks, since the attacks of September 11th 2001. Mr Zahrani himself had never been a soldier, wearing insignia or a uniform and carrying weapons openly; the label “unlawful enemy combatant” therefore seemed right, in American eyes. It also seemed right to them that neither the Geneva Conventions nor the usual American rules of legal process should apply to him. He was to be

confined without charge indefinitely; for, if released, it was clear that he would try to kill more Americans.

Mr Zahrani's ways of getting attention were fairly limited. One was to go on hunger strike. When the plastic pouch of breakfast came round—a pastry, cream cheese, an orange—he would refuse to open it. When lunch came—cereal bars, peanuts—he would push that aside, too. Once the guards realised he was on hunger strike, they would make him sign a waiver form to show he was aware that he might die. But Mr Zahrani apparently had no interest in dying, just in being a nuisance.

Means of martyrdom

He was not alone. A hunger strike last September involved more than 100 prisoners. Most of them, like him, went back to eating fairly quickly, rather than be strapped in restraint chairs and force-fed—the usual practice in American prisons—with liquid supplements or Gatorade through tubes inserted in their noses.

Others were more determined. Mr Zahrani was in touch with Ali Abdullah Ahmed, said to be a mid- to high-level operative for al-Qaeda, who had been force-fed after eight months on hunger strike. Together with another Saudi prisoner, Mani Shaman Turki al-Habardi al-Utaybi, allegedly a member of a jihadist recruiting group, they began to consider a different way of drawing attention to the cause.

That way was suicide—forbidden under Islam, but reinterpreted, by bombers and others, as a glorious act of martyrdom. Since Guantánamo had opened, in January 2002, there had been 41 suicide attempts, most of them, according to the military authorities, “manipulative, self-injurious behaviour”. In mid-May, Mr Zahrani would have heard of the “suicide attempt” that had been used to lure guards to a cell where, as they slipped on a floor slicked with excrement and soap, they were set upon by prisoners.

He himself, according to his family, was not the least suicidal. He did not wish to die, but to make a statement. Not just ideology lay behind it: a myth had taken hold in Guantánamo that if three prisoners killed themselves, they would all be released. Yet suicide was tricky. Mr Zahrani was not on medication, so he could not hoard pills for an overdose, as some others did. He was not in a cell—as in Camp 5, the new highest-security wing—where fans and electrical fittings could be fashioned into blades. But he had sheets and clothes from which, thread by thread, he could make a rope.

Since his cell could be easily seen into, discretion was essential. On June 10th, near midnight, he made his bed to look as if he was in it, wrote a suicide note, pushed a wad of cloth into his mouth, then hanged himself among the laundry drying from the ceiling. His colleagues did the same.

As he had hoped, his death led voices around the world to demand that the camp be closed. One senior American official, immovable, called his suicide “a good PR move”. She may have been right; Guantánamo, alas, remains wrong.

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Overview

Jun 15th 2006
From The Economist print edition

Many of the world's **stockmarkets** reached their lowest ebb for the year. Japan's Nikkei has lost 11% in 2006, Britain's FTSE 100 has lost 2%, as has Germany's DAX. The recent sell-off has also wiped out the year's gains for America's S&P 500. But the Dow Jones Industrial Average is still up this year, just.

Consumer prices in **America** rose by 0.4% in May, leaving them 4.2% higher than a year earlier. Core prices, excluding food and energy, rose by 0.3% for the third month in a row, thanks to rising housing rents. This resulted in an annual core-inflation rate of 2.4%—too high for the Federal Reserve's comfort and a cue for another interest-rate hike when the central bankers next meet, on June 29th, and perhaps after that, too.

The American economy also appears to be slowing, however. **Retail sales**, measured in dollars, were subdued, rising by just 0.1% in May. Meanwhile, America's trade deficit in goods and services widened slightly, to $63.4 billion in April.

Germany's ZEW Indicator of economic sentiment, based on a survey of analysts and institutional investors, fell in June thanks to a stronger euro, dear oil and the promise of higher interest rates. The indicator is now only slightly above its long-term average. But last spring's optimism found some confirmation in the data: Germany's industrial production grew at an annual pace of 3.4% in the three months to April. In **France** it fell by 2.4% over the same period.

In **Japan** prices for corporate goods rose by 3.3% in the year to May, the fastest pace for decades. Core orders for machinery (excluding those from shipping and electricity companies) were also strong, jumping by 10.8% in April, after falling by 5.2% in March. Orders often serve as a prelude to investment. Consumers, however, remain diffident. Japan's monthly survey of consumer confidence showed pessimists slightly outnumbering optimists in May.

In **Britain** the annual rate of consumer-price inflation rose to 2.2% in May, up from 2% in April. Unemployment edged up to 5.3% in the three months from February to April. But fewer people remained out of the labour force altogether: 21.1% of the working-age population was neither in work nor looking for a job, the lowest rate since 1992. Average earnings in the three months to April were 4.4% higher than in the same period a year earlier.

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About sponsorship

Output, demand and jobs

Jun 15th 2006
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)		Unemployment % rate	
	latest	qtr*	2006	2007	latest		latest		latest	year ago
Australia	+ 3.1 Q1	+ 3.5	+ 3.2	+ 3.4	+ 0.6	Q4	+ 2.7	Q1	4.9 May	5.1
Austria	+ 3.0 Q1	+ 2.4	+ 2.2	+ 1.9	+ 5.5	Mar	+ 1.0	Mar	4.8 May	5.1
Belgium	+ 2.2 Q1	+ 3.2	+ 2.3	+ 1.9	+ 5.1	Apr	– 0.8	Mar	12.0 May†	12.2
Britain	+ 2.2 Q1	+ 2.3	+ 2.4	+ 2.5	– 1.0	Apr	+ 3.0	Apr	5.3 Apr‡	4.7
Canada	+ 3.2 Q1	+ 3.8	+ 3.1	+ 2.8	+ 2.1	Mar	+ 4.4	Mar	6.1 May	6.9
Denmark	+ 4.3 Q1	+ 1.7	+ 2.7	+ 2.2	– 0.7	Apr	+ 2.1	Apr	4.8 Apr	6.0
France	+ 1.5 Q1	+ 2.2	+ 2.0	+ 1.9	– 0.3	Apr	+ 2.4	Apr	9.3 Apr	10.1
Germany	+ 1.4 Q1	+ 1.6	+ 1.8	+ 1.2	+ 4.8	Apr	– 1.0	Apr	11.0 May§	11.9
Italy	+ 1.5 Q1	+ 2.4	+ 1.3	+ 1.1	– 2.6	Apr	– 3.2	Mar	7.7 Dec	7.9
Japan	+ 3.8 Q1	+ 3.1	+ 2.9	+ 2.4	+ 3.6	Apr	– 1.5	Apr	4.1 Apr	4.4
Netherlands	+ 2.9 Q1	+ 0.7	+ 2.4	+ 2.0	+ 0.4	Apr	+ 4.0	Mar	5.7 Apr††	6.7
Spain	+ 3.5 Q1	+ 3.3	+ 3.2	+ 2.8	– 9.6	Apr	nil	Apr	8.3 Apr	9.5
Sweden	+ 4.1 Q1	+ 4.6	+ 3.4	+ 2.8	+ 6.2	Apr	+12.5	Apr	5.5 Apr†	5.8
Switzerland	+ 3.5 Q1	+ 3.8	+ 2.4	+ 1.7	+ 3.9	Q4	+ 0.7	Mar	3.3 May†	3.7
United States	+ 3.6 Q1	+ 5.3	+ 3.4	+ 2.8	+ 4.7	Apr	+ 4.6	Apr	4.6 May	5.1
Euro area	+ 1.9 Q1	+ 2.4	+ 2.1	+ 1.7	+ 3.8	Mar	+ 2.8	Apr	8.0 Apr	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*									
Finland	+ 2.8 Q1	+ 1.6	na	na	+ 5.9	Apr	+ 6.2	Mar	7.5 Apr	8.6
Greece	+ 4.1 Q1	na	na	na	– 1.9	Apr	+ 6.0	Mar	9.7 Q4	10.4
Iceland	+ 5.0 Q1	na	na	na	na		na		1.3 Apr†	2.3
Ireland	+ 5.7 Q4	+ 7.6	na	na	+10.8	Apr	+ 5.3	Mar	4.4 May	4.4
Luxembourg	+ 5.7 Q4	na	na	na	+ 5.8	Mar	+ 9.7	Apr	4.3 Apr	4.2
New Zealand	+ 1.9 Q4	nil	na	na	– 2.9	Q4	+ 3.0	Q1	3.9 Q1	3.9
Norway	+ 5.4 Q1	+ 2.3	na	na	– 7.5	Apr	– 1.2	Apr	4.0 Apr**	4.8
Portugal	+ 1.0 Q1	+ 1.8	na	na	– 1.7	Apr	+ 0.7	Apr	7.7 Q1†	7.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Feb-Apr; claimant count rate 3.0% in May.
§EU harmonised rate 8.2% in Apr. ††Feb-Apr. **Feb-Apr.

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About sponsorship

Prices and wages

Jun 15th 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 3.0	Q1	+ 2.4	+ 2.9	+ 2.7	+ 7.9	Q1	+ 6.0	+ 4.0	Q1	+ 4.5
Austria	+ 1.7	May	+ 2.3	+ 1.8	+ 1.8	+ 3.7	May	+ 1.3	+ 2.7	Apr	+ 2.2
Belgium	+ 2.2	May	+ 2.5	+ 2.0	+ 1.8	+ 4.9	Apr	+ 3.3	+ 2.2	Jan	+ 2.3
Britain	+ 2.2	May*	+ 1.9	+ 2.0	+ 1.9	+ 3.0	May	+ 2.7	+ 4.4	Apr†	+ 4.6
Canada	+ 2.4	Apr	+ 2.4	+ 2.3	+ 2.2	+ 2.2	Apr	+ 1.6	+ 0.2	Mar	+ 3.6
Denmark	+ 2.0	May	+ 1.5	+ 2.0	+ 2.0	+ 5.0	Apr	+ 3.8	+ 2.9	Q4	+ 2.9
France	+ 2.1	May	+ 1.5	+ 1.8	+ 1.5	+ 3.6	Apr	+ 3.3	+ 3.3	Q1	+ 2.9
Germany	+ 1.9	May	+ 1.7	+ 1.7	+ 2.3	+ 5.0	May	+ 1.7	+ 0.3	Mar	+ 1.5
Italy	+ 2.2	May	+ 1.9	+ 2.1	+ 1.8	+ 5.5	Apr	+ 4.4	+ 2.7	Apr	+ 3.5
Japan	+ 0.4	Apr	nil	+ 0.5	+ 0.6	+ 3.3	May	+ 1.8	+ 1.3	Apr	+ 0.8
Netherlands	+ 1.3	May	+ 1.3	+ 1.5	+ 1.5	+ 5.5	Apr	+ 5.2	+ 1.9	May	+ 0.4
Spain	+ 4.0	May	+ 3.1	+ 3.5	+ 2.9	+ 5.7	Apr	+ 5.0	+ 3.0	Q1	+ 2.5
Sweden	+ 1.6	May	+ 0.1	+ 1.3	+ 1.8	+ 4.7	Apr	+ 2.7	+ 1.7	Mar	+ 4.2
Switzerland	+ 1.4	May	+ 1.1	+ 1.2	+ 1.2	+ 1.9	Apr	+ 1.3	+ 1.0	2005	+ 0.9
United States	+ 4.2	May	+ 2.8	+ 3.3	+ 2.4	+ 4.5	May	+ 3.6	+ 3.7	May	+ 2.6
Euro area	+ 2.5	May	+ 2.0	+ 2.1	+ 2.0	+ 5.4	Apr	+ 4.3	+ 2.4	Q4	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.7	May	+ 0.8	na	na	+ 6.1	Apr	+ 3.1	+ 3.4	Q1	+ 4.0
Greece	+ 3.1	May	+ 3.2	na	na	+ 7.9	Apr	+ 4.4	na		na
Iceland	+ 8.0	Jun	+ 2.8	na	na	+ 6.9	May	+ 4.5	+ 8.4	Apr	+ 6.7
Ireland	+ 3.9	May	+ 2.4	na	na	+ 1.7	Apr	– 1.8	+ 3.8	Q4	+ 4.6
Luxembourg	+ 3.1	May	+ 2.4	na	na	+ 4.1	Mar	+15.2	+ 4.5	Mar	+ 2.5
New Zealand	+ 3.3	Q1	+ 2.8	na	na	+ 7.2	Q1	+ 4.2	+ 3.3	Q1	+ 2.5
Norway	+ 2.3	May	+ 1.6	na	na	+19.8	May	+ 9.2	+ 3.6	Q1	+ 4.2
Portugal	+ 2.9	Apr	+ 2.1	na	na	+ 4.8	Apr	+ 4.4	+ 0.1	Apr	– 1.8

*RPI inflation rate 3.0% in May. †Feb-Apr.

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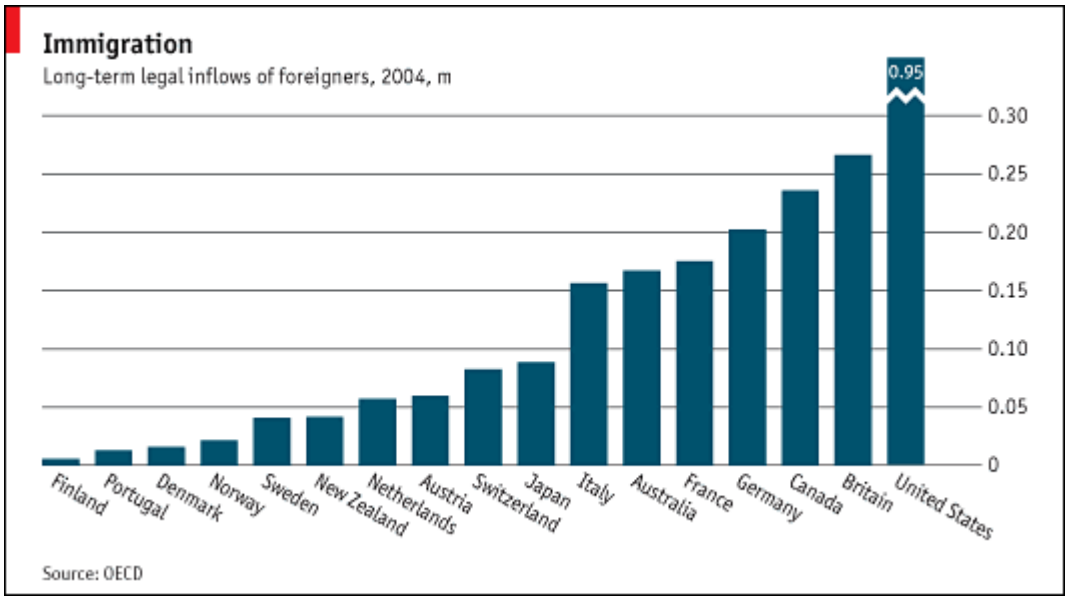
Immigration

Jun 15th 2006
From The Economist print edition



Immigration to America rose by more than a third in 2004, according to the OECD, which counts only migrants on long-term resident visas. It also rose sharply in Britain and Italy. In the 12 months after EU enlargement in May 2004, 83,000 migrants from the new member states registered to work in Ireland, equivalent to 4% of its labour force.

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Money and interest rates

Jun 15th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jun 14th 2006)					
				3-mth money market		2-year gov't bonds	10-year gov't bonds		corporate bonds
	narrow	broad		latest	year ago		latest	year ago	
Australia	+ 9.5	+10.4	Apr	5.95	5.67	5.63	5.60	5.25	6.65
Britain	+ 7.5	+13.1	Apr	4.67	4.81	4.66	4.52	4.39	5.56§
Canada	+ 8.7	+ 5.8	Apr	4.21	2.43	4.23	4.37	4.00	5.49
Denmark	+12.8	+10.5	Apr	3.02	2.20	3.45	3.89	3.20	5.21
Japan	+ 4.4	+ 1.4	May	0.22	0.02	0.71	1.80	1.22	1.86
Sweden	+ 0.4	+11.9	Apr	2.20	1.65	2.97	3.79	3.16	3.73
Switzerland	+ 3.1	+ 4.6	Apr	1.48	0.75	1.96	2.61	2.04	2.63
United States	+ 1.9	+ 4.9	Apr‡	5.20	3.26	5.09	5.04	4.11	5.98
Euro area†	+ 9.8	+ 8.8	Apr	2.96	2.11	3.30	3.85	3.25	4.42

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series for broad money supply. §New series. Benchmarks: US 30-year 5.09%, Japan No. 280 1.77%. Central bank rates: US fed funds 5.00%, ECB refinancing 2.75%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jun 15th 2006
From The Economist print edition

2000=100

	Jun 6th	Jun 13th*	% change on one month	% change on one year
Dollar index				
All items	174.5	167.5	- 8.1	+ 25.5
Food	136.1	134.6	- 3.7	+ 4.1
Industrials				
All	224.3	210.1	-11.4	+ 51.2
Nfa†	162.0	165.9	+ 5.8	+ 28.9
Metals	258.2	234.2	-16.7	+ 62.0
Sterling index				
All items	142.3	138.3	- 5.6	+ 23.4
Euro index				
All items	126.0	123.3	- 6.0	+ 20.3
Yen index				
All items	183.8	179.1	- 3.8	+ 32.3
Gold				
$ per oz	626.50	576.50	-16.3	+ 35.1
West Texas Intermediate				
$ per barrel	72.44	70.21	+ 1.3	+ 27.8

*Provisional. †Non-food agriculturals.

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Stockmarkets

Jun 15th 2006
From The Economist print edition

Market indices

	Jun 14th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	4,815.0	5,318.2	4,708.8	– 3.5	– 9.5	+ 2.3	+ 3.0
Austria (ATX)	3,365.3	4,344.4	3,324.1	– 8.3	– 22.5	– 8.2	– 1.8
Belgium (Bel 20)	3,445.3	3,987.3	3,445.1	– 3.9	– 13.6	– 2.9	+ 3.8
Britain (FTSE 100)	5,506.8	6,132.7	5,506.8	– 3.5	– 20.5	– 2.0	+ 5.4
Canada (Toronto Composite)	10,960.7	12,487.3	10,904.3	– 4.5	– 12.2	– 2.8	+ 2.1
Denmark (OMXCB)	326.1	395.5	325.0	– 6.4	– 17.5	– 11.3	– 5.1
France (SBF 250)	3,244.8	3,755.6	3,244.2	– 4.5	– 26.1	– 1.7	+ 5.2
France (CAC 40)	4,615.4	5,312.2	4,615.4	– 4.3	– 33.3	– 2.1	+ 4.7
Germany (DAX)*	5,306.0	6,140.7	5,292.1	– 4.3	– 34.2	– 1.9	+ 5.0
Italy (S&P/MIB)	34,850.0	38,765.0	34,850.0	– 3.5	– 30.5	– 2.4	+ 4.4
Japan (Nikkei 225)	14,309.6	17,563.4	14,218.6	– 5.2	– 63.2	– 11.2	– 8.7
Japan (Topix)	1,466.1	1,783.7	1,458.3	– 4.4	– 49.2	– 11.1	– 8.7
Netherlands (AEX)	413.0	478.0	412.9	– 4.4	– 41.1	– 5.4	+ 1.1
Spain (Madrid SE)	1,177.6	1,318.5	1,156.8	– 3.6	– 10.7	+ 1.9	+ 9.0
Sweden (Affarsvarlden Gen)	280.9	333.7	275.2	– 4.5	– 29.8	– 4.3	+ 3.7
Switzerland (Swiss Market)	7,171.0	8,122.1	7,154.9	– 5.0	– 14.8	– 5.4	+ 1.4
United States (DJIA)	10,816.9	11,642.7	10,667.4	– 1.0	– 7.7	+ 0.9	+ 0.9
United States (S&P 500)	1,230.0	1,325.8	1,223.7	– 2.1	– 19.5	– 1.5	– 1.5
United States (NASDAQ Comp)	2,086.0	2,370.9	2,072.5	– 3.1	– 58.7	– 5.4	– 5.4
Europe (FTSEurofirst 300)†	1,240.2	1,405.6	1,238.7	– 3.8	– 27.3	– 2.8	+ 4.0
Euro area (FTSE Euro 100)†	1,051.0	1,198.7	1,050.0	– 4.1	– 32.2	– 3.5	+ 3.2
World (MSCI)‡	1,250.9	1,406.3	1,243.9	– 3.6	– 13.7	– 0.5	– 0.5
World bond market (Citigroup)††	637.3	648.4	612.1	– 0.4	– 4.4	+ 2.7	+ 2.7

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Jun 15th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Jun 14th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Jun 14th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2005‡
Australia	− 11.7 Apr	− 40.6 Q1	− 5.6	− 5.0	115.0	117.9	1.35	1.30	2.50	1.71	1.18	+ 1.5
Austria	− 1.2 Mar	+ 0.5 Dec	+ 0.1	+ 0.1	105.3§	105.7	0.79	0.83	1.46	–	0.69	− 1.6
Belgium	+ 11.1 Mar	+ 6.6 Dec	+ 2.0	+ 2.0	107.1§	107.6	0.79	0.83	1.46	–	0.69	− 0.1
Britain	−126.3 Apr	− 57.4 Q4	− 2.7	− 2.7	100.3	101.4	0.54	0.55	–	0.68	0.47	− 3.2
Canada	+ 57.6 Apr	+ 31.8 Q1	+ 2.2	+ 1.5	129.7	116.4	1.11	1.24	2.05	1.40	0.97	+ 1.7
Denmark	+ 8.5 Apr	+ 5.3 Apr	+ 2.5	+ 2.3	106.3	105.5	5.91	6.15	10.9	7.46	5.15	+ 4.0
France	− 28.0 Apr	− 43.6 Mar	− 1.8	− 1.4	107.9§	108.5	0.79	0.83	1.46	–	0.69	− 2.9
Germany	+188.7 Apr	+109.3 Apr	+ 3.8	+ 4.0	109.4§	110.1	0.79	0.83	1.46	–	0.69	− 3.3
Italy	− 17.6 Mar	− 28.5 Mar	− 1.6	− 1.5	107.5§	108.0	0.79	0.83	1.46	–	0.69	− 4.3
Japan	+ 80.7 Apr	+162.7 Apr	+ 3.6	+ 3.4	81.9	87.5	115	109	212	145	–	− 5.2
Netherlands	+ 39.5 Mar	+ 42.3 Q1	+ 5.8	+ 5.7	108.0§	108.4	0.79	0.83	1.46	–	0.69	− 0.3
Spain	− 99.9 Mar	− 85.6 Feb	− 7.3	− 7.4	105.6§	105.9	0.79	0.83	1.46	–	0.69	+ 1.1
Sweden	+ 20.0 Apr	+ 23.2 Q1	+ 6.5	+ 6.2	97.5	96.2	7.35	7.67	13.6	9.27	6.40	+ 2.7
Switzerland	+ 7.9 Apr	+ 50.2 Q4	+13.0	+12.3	107.3	106.8	1.23	1.27	2.27	1.55	1.07	− 0.5
United States	−814.7 Apr	−804.9 Q4	− 6.9	− 6.9	83.5	85.7	–	–	1.85	1.26	0.87	− 3.8
Euro area	+ 6.7 Mar	− 44.7 Mar	− 0.3	− 0.2	118.0	114.3	0.79	0.83	1.46	–	0.69	− 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 7.1 Apr	+ 5.4 Apr	na	na	108.7§	109.2	0.79	0.83	1.46	–	0.69	+ 2.4
Greece	− 36.4 Mar	− 21.4 Mar	na	na	104.7§	104.9	0.79	0.83	1.46	–	0.69	− 4.4
Iceland	− 1.8 Apr	− 2.6 Q4	na	na	101.8**	101.3	75.7	66.0	140	95.5	65.9	+ 3.2
Ireland	+ 38.2 Mar	− 3.9 Q4	na	na	113.1§	114.0	0.79	0.83	1.46	–	0.69	+ 1.0
Luxembourg	− 4.9 Mar	+ 3.6 Q4	na	na	107.1§	107.6	0.79	0.83	1.46	–	0.69	− 1.9
New Zealand	− 4.8 Apr	− 9.6 Q4	na	na	122.7	138.4	1.60	1.41	2.95	2.02	1.39	+ 5.8
Norway	+ 52.2 Apr	+ 50.2 Q1	na	na	111.7	109.9	6.23	6.52	11.5	7.86	5.43	+ 15.8
Portugal	− 22.8 Mar	− 17.0 Mar	na	na	105.1**	106.1	0.79	0.83	1.46	–	0.69	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, April average. ‡OECD estimate. **IMF, February average.

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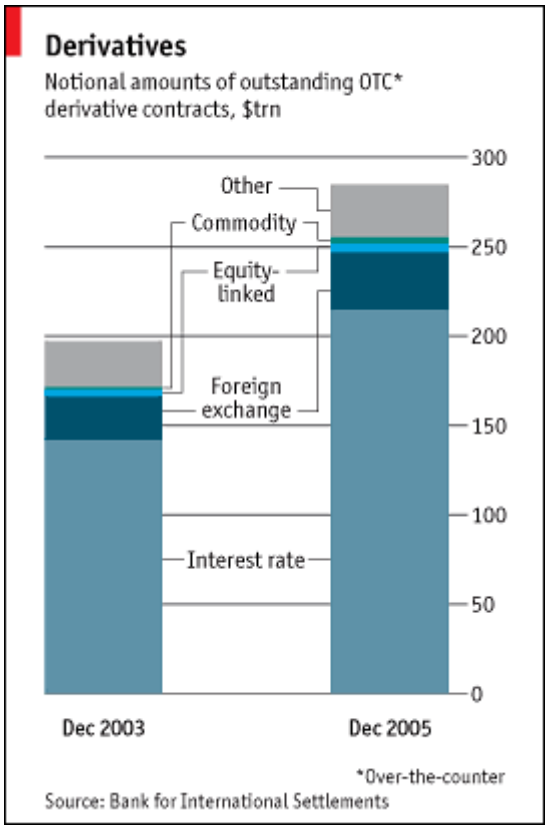
Derivatives

Jun 15th 2006
From The Economist print edition



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Overview

Jun 15th 2006
From The Economist print edition

Emerging-market equities suffered a terrible week. **Share prices** fell by more than 10% in Colombia, Egypt, Hungary, Pakistan, Poland, Russia and Turkey.

China's monthly trade surplus soared to $13 billion in May, a record. The 12-month surplus was $118.1 billion.

India's industrial output rose by 9.5% in the year to April, far more than expected.

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Czech Republic

Jun 15th 2006
From The Economist print edition

Growth in the Czech Republic used to lag behind that of its peers in eastern Europe. Now it surpasses theirs. The country's sound monetary policy leaves it well placed to join the euro as planned in 2010, according to the OECD's latest survey. But the improvement in the country's fiscal fortunes reflects luck more than judgment. Tax revenues were stronger than expected and spending was deferred, not cut.

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Economy

Jun 15th 2006
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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+10.2	Q1	+17.9	May	+ 1.4	May	+118.1	May	+160.8	2005	875.1	Mar
Hong Kong	+ 8.2	Q1	+ 5.9	Q4	+ 1.9	Apr	−12.4	Apr	+20.3	Q4	126.5	May
India	+ 9.3	Q1	+ 9.5	Apr	+ 5.0	Apr	−39.7	Apr	−13.3	Q4	156.7	May
Indonesia	+ 4.6	Q1	+ 0.2	Mar	+15.6	May	+31.6	Apr	+ 3.0	Q4	38.3	Mar
Malaysia	+ 5.3	Q1	+ 4.7	Apr	+ 4.6	Apr	+26.4	Apr	+19.9	Q4	75.2	Apr
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 6.2	Apr	−10.7	Apr	− 4.8	Q1	11.5	Apr
Philippines	+ 5.5	Q1	− 6.6	Mar	+ 6.9	May	− 3.6	Mar	+ 2.4	Dec	18.1	May
Singapore	+10.6	Q1	+ 3.0	Apr	+ 1.1	Apr	+33.2	Apr	+36.1	Q1	128.9	May
South Korea	+ 6.1	Q1	+ 9.5	Apr	+ 2.4	May	+18.7	May	+ 9.0	Apr	224.7	May
Taiwan	+ 4.9	Q1	+ 5.5	Apr	+ 1.6	May	+10.1	May	+18.1	Q1	260.9	May
Thailand	+ 6.0	Q1	+ 7.2	Apr	+ 6.2	May	− 4.7	Apr	+ 0.4	Apr	55.5	Apr
Argentina	+ 9.1	Q4	+ 4.9	Apr	+11.5	May	+10.2	Apr	+ 5.4	Q4	21.2	Apr
Brazil	+ 3.4	Q1	− 1.9	Apr	+ 4.2	May	+44.6	May	+12.8	Apr	56.9	Apr
Chile	+ 5.1	Q1	+ 0.9	Apr	+ 3.7	May	+14.2	May	+ 0.8	Q1	17.4	May
Colombia	+ 5.4	Q1	+12.6	Mar	+ 4.0	May	+ 1.4	Feb	− 1.9	Q4	14.5	May
Mexico	+ 5.5	Q1	− 0.8	Apr	+ 3.0	May	− 3.7	Apr	− 1.2	Q1	78.4	Apr
Peru	+10.7	Mar	+ 9.8	Mar	+ 2.2	May	+ 5.7	Apr	+ 0.7	Q1	13.3	Apr
Venezuela	+ 9.4	Q1	+ 8.7	Feb	+10.4	May	+34.8	Q1	+28.1	Q1	23.7	Apr
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 5.3	May	−11.1	Q4	+ 2.2	Q4	22.1	May
Israel	+ 5.2	Q1	+ 6.6	Mar	+ 3.8	Apr	− 8.1	May	+ 2.4	Q4	28.2	May
Saudi Arabia	+ 6.2	2005‡	na		+ 2.5	Mar	+134.3	2005	+90.7	2005	24.0	Apr
South Africa	+ 4.0	Q1	+ 0.1	Apr	+ 3.3	Apr	− 5.5	Apr	−10.1	Q4	21.5	May
Czech Republic	+ 7.4	Q1	+ 3.6	Apr	+ 3.1	May	+ 1.7	Apr	− 3.4	Q1	30.8	May
Hungary	+ 4.6	Q1	+ 6.8	Apr	+ 2.8	May	− 3.1	Apr	− 8.0	Q4	20.5	Apr
Poland	+ 5.2	Q1	+10.2	Apr	+ 1.2	May	− 2.6	Apr	− 4.4	Apr	43.3	Apr
Russia	+ 7.9	Q4	+ 4.8	Apr	+ 9.5	May	+132.3	Apr	+92.0	Q1	239.3	May
Turkey	+ 9.5	Q4	+ 7.1	Apr	+ 9.9	May	−47.5	Apr	−26.9	Apr	59.8	Apr
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+11.6	Q1	+ 5.5	Apr	+ 4.7	May	− 2.6	Mar	− 1.5	Apr	2.2	Apr
Latvia	+13.5	Q1	+ 0.4	Apr	+ 6.5	May	− 3.3	Apr	− 2.1	Apr	2.6	Apr
Lithuania	+ 8.1	Q1	na		+ 3.6	May	− 3.7	Apr	− 1.8	Apr	4.0	Apr
Slovakia	+ 6.3	Q1	+ 8.1	Apr	+ 4.8	May	− 2.8	Apr	− 4.5	Feb	16.2	Apr
Slovenia	+ 5.1	Q1	+ 0.6	Apr	+ 3.2	May	− 1.6	Apr	− 0.4	Mar	8.3	Mar

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Jun 15th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jun 14th		Dec 30th 2005	
	Jun 14th	year ago	Jun 14th	% a year		one week	in local currency	in $ terms
China	8.00	8.28	14.8	2.65	1,609.6	– 3.6	+ 31.8	+ 33.0
Hong Kong	7.76	7.77	14.3	4.68	15,247.9	– 3.6	+ 2.5	+ 2.4
India	45.9	43.6	84.8	5.72	8,929.4	– 8.5	– 5.0	– 6.9
Indonesia	9,480	9,608	17,504	13.21	1,234.2	– 4.1	+ 6.2	+ 10.2
Malaysia	3.67	3.80	6.78	3.93	893.2	– 3.3	– 0.7	+ 2.2
Pakistan	60.1	59.7	111	9.26	8,769.0	–14.0	– 8.2	– 8.8
Philippines	53.2	55.3	98.2	8.00	2,067.0	– 6.8	– 1.4	– 1.7
Singapore	1.59	1.67	2.94	3.44	2,280.7	– 3.2	– 2.8	+ 1.3
South Korea	962	1,013	1,776	4.44	1,221.7	– 3.6	– 11.4	– 6.9
Taiwan	32.6	31.4	60.2	1.70	6,469.0	– 2.2	– 1.2	– 0.4
Thailand	38.4	40.9	70.9	5.35	646.7	– 6.0	– 9.4	– 3.2
Argentina	3.08	2.86	5.69	9.81	1,509.6	– 6.8	– 2.2	– 3.9
Brazil	2.29	2.44	4.23	15.19	32,941.0	– 6.6	– 1.5	+ 0.5
Chile	544	589	1,005	5.04	9,413.2	– 3.7	+ 2.2	– 3.8
Colombia	2,562	2,330	4,730	6.01	6,562.3	–20.1	– 31.0	– 38.4
Mexico	11.4	10.8	21.1	7.02	16,802.1	– 8.8	– 5.6	– 12.3
Peru	3.27	3.25	6.03	4.51	7,477.8	– 3.6	+ 55.7	+ 63.6
Venezuela	2,690§	2,630§	4,967	10.12	30,275.3	– 1.2	+ 48.4	+ 42.7
Egypt	5.76	5.80	10.64	8.71	42,201.9	–13.6	– 23.8	– 24.1
Israel	4.48	4.47	8.27	5.57	825.5	– 3.2	– 0.3	+ 2.5
Saudi Arabia	3.75	3.75	6.93	4.88	12,046.1	+5.6	– 27.9	– 27.9
South Africa	6.85	6.81	12.7	7.55	18,753.7	– 4.8	+ 3.6	– 4.1
Czech Republic	22.5	24.8	41.5	2.10	1,190.0	– 8.5	– 19.2	– 11.6
Hungary	214	206	396	6.41	18,561.1	–11.0	– 10.7	– 10.9
Poland	3.20	3.35	5.91	4.18	36,020.7	–10.5	+ 1.2	+ 3.0
Russia	27.0	28.6	49.9	12.00	1,274.4‡	–11.0	+ 6.5	+ 13.2
Turkey	1.60	1.37	2.96	17.41	32,899.7	–10.4	– 17.3	– 30.3
EM (MSCI)*	1.00	1.00	1.85	na	673.3	– 7.3	– 4.7	– 4.7
EMBI+†	1.00	1.00	1.85	na	366.2	– 0.6	– 0.7	– 0.7

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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